THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

(102–1)

HEARINGS

BEFORE THE

SUBCOMMITTEE ON AVIATION

OF THE

COMMITTEE ON
PUBLIC WORKS AND TRANSPORTATION
HOUSE OF REPRESENTATIVES

ONE HUNDRED SECOND CONGRESS

FIRST SESSION

FEBRUARY 5 AND 6, 1991

Printed for the use of the
Committee on Public Works and Transportation

U.S. GOVERNMENT PRINTING OFFICE
41-650 WASHINGTON : 1991

H641-40

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

ROBERT A. ROE, New Jersey, *Chairman*

GLENN M. ANDERSON, California, *Vice Chair*
NORMAN Y. MINETA, California
JAMES L. OBERSTAR, Minnesota
HENRY J. NOWAK, New York
NICK JOE RAHALL II, West Virginia
DOUGLAS APPLEGATE, Ohio
RON de LUGO, Virgin Islands
GUS SAVAGE, Illinois
ROBERT A. BORSKI, Pennsylvania
JOE KOLTER, Pennsylvania
TIM VALENTINE, North Carolina
WILLIAM O. LIPINSKI, Illinois
PETER J. VISCLOSKY, Indiana
JAMES A. TRAFICANT, Jr., Ohio
JOHN LEWIS, Georgia
PETER A. DeFAZIO, Oregon
JIMMY HAYES, Louisiana
BOB CLEMENT, Tennessee
LEWIS F. PAYNE, Jr., Virginia
JERRY F. COSTELLO, Illinois
FRANK PALLONE, Jr., New Jersey
BEN JONES, Georgia
MIKE PARKER, Mississippi
GREG LAUGHLIN, Texas
PETE GEREN, Texas
GEORGE E. SANGMEISTER, Illinois
GLENN POSHARD, Illinois
DICK SWETT, New Hampshire
BILL K. BREWSTER, Oklahoma
BUD CRAMER, Alabama
ROSA L. DeLAURO, Connecticut
JOAN KELLY HORN, Missouri
BARBARA-ROSE COLLINS, Michigan
PETE PETERSON, Flordia
ELEANOR HOLMES NORTON, District of Columbia

JONH PAUL HAMMERSCHMIDT, Arkansas
BUD SHUSTER, Pennsylvania
WILLIAM F. CLINGER, Jr., Pennsylvania
THOMAS E. PETRI, Wisconsin
RON PACKARD, California
SHERWOOD BOEHLERT, New York
HELEN DELICH BENTLEY, Maryland
JAMES M. INHOFE, Oklahoma
CASS BALLENGER, North Carolina
FRED UPTON, Michigan
BILL EMERSON, Missouri
JOHN J. DUNCAN, Jr., Tennessee
MEL HANCOCK, Missouri
CHRISTOPHER COX, California
SUSAN MOLINARI, New York
DAVID L. HOBSON, Ohio
FRANK D. RIGGS, California
CHARLES H. TAYLOR, North Carolina
DICK NICHOLS, Kansas
WILLIAM H. ZELIFF, Jr., New Hampshire
(Vacancy)

Subcommittee on Aviation

JAMES L. OBERSTAR, Minnesota, *Chairman*

JOAN KELLY HORN, Missouri, *Vice Chair*
BARBARA-ROSE COLLINS, Michigan
NORMAN Y. MINETA, California
HENRY J. NOWAK, New York
NICK JOE RAHALL II, West Virginia
RON de LUGO, Virgin Islands
GUS SAVAGE, Illinois
JOE KOLTER, Pennsylvania
TIM VALENTINE, North Carolina
WILLIAM O. LIPINSKI, Illinois
JAMES A. TRAFICANT, Jr., Ohio
JOHN LEWIS, Georgia
PETER A. DeFAZIO, Oregon
JIMMY HAYES, Louisiana
BOB CLEMENT, Tennessee
LEWIS F. PAYNE, Jr., Virginia
JERRY F. COSTELLO, Illinois
MIKE PARKER, Mississippi
GREG LAUGHLIN, Texas
PETE GEREN, Texas
GEORGE E. SANGMEISTER, Illinois
GLENN POSHARD, Illinois
DICK SWETT, New Hampshire
ROBERT A ROE, New Jersey (Ex Officio)

WILLIAM F. CLINGER, Jr., Pennsylvania
BUD SHUSTER, Pennsylvania
THOMAS E. PETRI, Wisconsin
SHERWOOD BOEHLERT, New York
JAMES M. INHOFE, Oklahoma
CASS BALLENGER, North Carolina
JOHN J. DUNCAN, Jr., Tennessee
MEL HANCOCK, Missouri
CHRISTOPHER COX, California
SUSAN MOLINARI, New York
DAVID L. HOBSON, Ohio
DICK NICHOLS, Kansas
(Vacancy)
JOHN PAUL HAMMERSCHMIDT, Arkansas (Ex Officio)

CONTENTS

Proceedings of: Page
- February 5, 1991 1
- February 6, 1991 385

Summary of Subject Matter v

FEBRUARY 5, 1991

TESTIMONY

Babbitt, Randy, President, Airline Pilots Association accompanied by R. Russell Bailey, Attorney, ALPA 97
Beauvais, Edward R., Chairman and CEO, American West Airlines 61
Dempsey, Paul, Professor, University of Denver, School of Law 119
Kasper, Dan, Harbridge House, Inc 119
Mathias, Richard, Senior Vice President, Government Affairs for Pan American World Airways 61
Morrison, Dr. Steven, Department of Economics, Northwestern University 119
Myers, A. Maurice, Chief Executive Officer, Aloha Airlines, Inc 61
Scheri, William L., V.P. Tranportation, International Association of Machinists accompanied by Robert Clayman, Greary, Edmund, and James 97
Seiden, Elliott, Vice President, Law and Government Affairs, Northwest Airlines 61
Skinner, Hon. Samuel K., Secretary, United States Department of Transportation 10
Vecci, Raymond J., Chief Executive Officer of Alaska Airlines 61

PREPARED STATEMENTS SUBMITTED BY MEMBERS OF CONGRESS

Costello, Hon. Jerry, F., a Representative in Congress from Illinois 6
Hammerschmidt, Hon. John Paul, a Representative in Congress from Arkansas 60
Horn, Hon. Joan Kelly, a Representative in Congress from Missouri 8
Payne, Hon. Lewis F., Jr., a Representative in Congress from Virginia 60

PREPARED STATEMENTS OF WITNESSES

Babbitt, Capt. Randolph 141
Beauvais, Edward, R., with attachments 164
Dempsey, Paul Stephen 281
Kasper, Daniel M 305
Mathias, Richard 312
Morrison, Steven A 324
Myers, A. Maurice 334
Scheri, William L. (John F. Peterpaul) 344
Seiden, Elliott 352
Skinner, Hon. Samuel K 361
Vecci, Raymond J 374

SUBMISSIONS FOR THE RECORD

de Lugo, Hon. Ron, A Delegate in Congress from the Virgin Islands, responses to questions submitted to Secretary Skinner regarding airline service from the Virgin Islands 34
Lipinski, Hon. William O., a Representative in Congress from Illinois, information received from Secretary Skinner regarding the number of weekly departures by foreign carriers from United States hubs 42

Page
Molinari, Hon. Susan, a Representative in Congress from New York, response from Secretary Skinner regarding the Federal Aviation Administration's FY 1992 Budget Summary 40
Parker, Hon. Mike, a Representative in Congress from Mississippi, responses to questions submitted to Secretary Skinner 47

FEBRUARY 6, 1991

TESTIMONY

Baggaley, Philip, Senior Vice President, Standard & Poor Corp 432
Becker, Helane, Executive Vice President and Head of the Transportation Research Group, Lehman Brothers 432
Borer, David, Director of Collective Bargaining, Association of Flight Attendants 456
Dorgan, Hon. Byron, a Representative in Congress from North Dakota 385
Frankovich, Victoria L., President, Independent Federation of Flight Attendants 456
Landry, James, Senior Vice President, Air Transport Association of America .. 421
Leon, Cheryle, President, Association of Professional Flight Attendants 456
Mead, Kenneth M., Director, Transportation Issues, Resources, Community and Economic Development Division, U.S. General Accounting Office accompanied by Jay Cherlow, Frank Mulvey, Jack Wells, and Dolores Parrett 395
Moreau, Brian, President, Independent Union of Flight Attendants 456
Pettee, Timothy, Vice President, Alliance Capital Management 432

PREPARED STATEMENTS OF WITNESSES

Baggaley, Philip 479
Becker, Helane 484
Frankovich, Victoria L 491
Landry, James 502
Leon, Cheryle, with attachment 533
Mead, Kenneth M 550
Moreau, Brian 574
Pettee, Timothy 584

STATEMENT SUBMITTED BY MEMBER OF CONGRESS

Dorgan, Hon. Byron, a Representative in Congress from North Dakota 393

ADDITIONS TO THE RECORD

Burhop, William J., Vice President, Federal Affairs, American Airlines, letter 594
Davidoff, David G., President and Chief Executive Officer, American Society of Travel Agents, letter 597
Kindig, Marion, President, R. O. B., letter and exhibits 601

SUBCOMMITTEE ON AVIATION

hearing on

THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY & THE ADEQUACY OF COMPETITION

Tuesday, February 5, 1991
Wednesday, February 6, 1991

SUMMARY OF SUBJECT MATTER

In recent months, the airline industry has encountered serious financial difficulties which threaten the survival of several major airlines. This has raised concerns that there will not be enough competition remaining to sustain the low fares and other consumer benefits of airline deregulation. Further concerns have been raised by the policies of the Department of Transportation to deal with these problems; particularly DOT's recent announcement that it intends to change policies and legal interpretations limiting foreign investment in United States airlines, and DOT decisions allowing financially weak carriers to sell their international routes to stronger airlines. DOT's new policy on foreign investment was announced without Congressional consultation, and is contrary the intent of legislation passed by the House in 1989.

In this context, the Subcommittee hearings will examine the financial condition of the airline industry, whether there is likely to continue to be enough competition to sustain the benefits of deregulation, and whether any legislative or regulatory action should be taken to improve the industry's financial condition, enhance competition, or protect consumers by reregulating service or fares.

1 - Deregulation and Competition.

Before 1978, the airline industry was regulated with the markets that airlines served and the fares they charged determined by the Civil Aeronautics Board. Government regulation was expected to ensure that the public received good service at reasonable fares, and, at the same time, prevent "excessive" competition which would result in financial losses threatening the survival of major airlines.

The Airline Deregulation Act of 1978 ended most government economic regulation and gave the airlines freedom to determine their markets and fares. At the time of deregulation there was a widespread belief that free market competition could do a better job than government regulation in providing the best possible service for the public.

Deregulation depends on effective competition. The theory of deregulation is that when a carrier begins to abuse its position by charging excessive fares or providing poor service, another airline (a new carrier or an existing carrier expanding service) will enter the market and compete by offering lower fares or improved service.

2 - Experience Under Deregulation.

Most evaluations of deregulation have concluded that it has provided substantial benefits to consumers. There is much less agreement about whether these benefits are likely to continue in the 1990s, in the face of an expected decrease in the number of major airlines.

A major consumer benefit of deregulation has been low fares. An extensive Department of Transportation study found that between 1979 and 1988 average domestic airline fares increased by 34%, which was considerably less than the increase of 63% in the Consumer Price Index during the same period. During 1989 and 1990 average airline fares increased about 3.75% a year, somewhat less than the CPI.

The benefits of low fares have been widely distributed. Data collected by the Air Transport Association shows that in 1990, 91% of domestic air trips involved some form of discount, with the average discount at 65%.

In the last few years there have been concerns that passengers in non-competitive markets are not receiving all the benefits of deregulation. Studies by the General Accounting Office have concluded that in 1988 and the first half of 1989, fares at large airports with limited competition were about 27% higher than fares at airports where there was more competition. Similarly, a Department of Transportation study found that in 1988 fares paid for local service from concentrated hub airports (airports where airlines provide banks of connecting flights) were 18.7% higher than fares paid in more competitive markets of similar distance and size.* The airlines have disagreed with these conclusions and have conducted their own studies which conclude that fares at hub airports are not higher than fares at non-hub airports.

Studies have also shown that deregulation has resulted in more service for the public. A recent DOT study showed the following increases in service between 1978 and 1989.

Table I - Growth in Weekly Service 1978-1989

Size of City	Growth in Weekly Flights 1978-1989
28 Large Cities	61.1%
29 Medium Cities	69.8%
58 Small Cities	33.2%
382 Rural/Small Communities	43.9%

There has also been an increase in the number of air carriers serving individual markets. In 1988 more than 55% of passengers traveled in city pair markets served by three or more carriers, up from 28% in 1979. This increase has resulted largely from the development of connecting hubs at which an airline provides service between a large number of cities on either side of the hub, through a connection at the hub.

---

*Similarly, DOT found that in monopoly markets (which involved about 10% of all domestic passengers) fares were about 10% higher than in comparable competitive markets.

3 - Decline in Number of Competitors.

When deregulation was enacted in 1978, it was generally believed that there would be an increase in the number of competitors. The success of unregulated small intra-state airlines, such as PSA and Southwest, in competing against larger regulated carriers suggested that the optimum size of an airline was relatively small, and that large airlines would not be flexible enough to respond to competition.

In the early years of deregulation this theory seemed to be working as many new competitors entered the industry. Between 1978 and 1983 the market share of the top eight carriers decreased from 81% to 74%.

In the mid-1980s the trend reversed. The new entrants and a number of smaller pre-deregulation airlines encountered financial difficulties and either failed or merged. Of the 22 major new entrants since deregulation, only four survived; the others either failed, were acquired by other carriers, or changed to commuter service. Between 1985 and 1987, the Department of Transportation approved 10 major carrier mergers. As a result, the market share of the top 8 carriers in the industry increased from 74% of revenue passenger miles in 1983 to about 90% today.

A number of explanations have been advanced for this increase in industry concentration. The large pre-deregulation carriers have followed competitive strategies which have given them substantial advantages over new entrants and smaller competitors. These strategies, which were discussed at length in 1989 Subcommittee hearings on the Adequacy of Competition in the Airline Industry (Committee print 101-24), included developing strong hubs at which other carriers are unable to obtain access to the airport facilities needed to compete; frequent flier programs; yield management programs which limit the availability of discount fares to situations in which they are competitively necessary; and the control of airline computer reservations systems used by travel agents. The increase in industry concentration has also been attributed to the unwillingness of the Department of Transportation to disapprove mergers, and DOT's unwillingness to proceed against anti-competitive situations, such as the domination of computer reservations systems by the two largest airlines, American and United.

Turning to the current situation, at the end of 1990, there were eleven major airlines which as a group controlled more than 95% of the domestic market.

Table II - Industry Structure 1990

Carrier	Share of Domestic RPMS (1st 11 mos. 1990)
American	16.9%
Delta	16.7%
Northwest	12.9%
Continental	8.6%
TWA	7.8%
USAir	7.7%
Pan Am	6.8%
Eastern	3.7%
America West	2.4%
Southwest	2.2%
Top Eleven	97%

In recent months, the industry has faced extreme financial difficulties. 1990 losses will total $2.0 billion. The fourth quarter of 1990 was one of the worst in the industry's history, with a net loss of about $1.7 billion. The causes of these losses include the economic recession and the increase in jet fuel costs since the Gulf crisis began in August. The average cost of fuel per gallon for domestic service rose from $.57 in July to $1.09 in December. Each $.01 increase in fuel costs adds $164 million in annual costs for the industry. Since the outbreak of war, the industry's problems have been exacerbated by a fall in traffic because of concerns over terrorism.

The industry's recent financial difficulties have created strong concerns that there will soon be a substantial further increase in industry concentration. One of the top eleven carriers, Eastern, with a 3.7% market share, has shut down. Two more, Continental and Pan American, with a combined market share of 15.4%, are in Chapter 11 bankruptcy reorganization and are selling international routes. TWA and Northwest have large financial obligations for debt incurred in connection with leveraged buyouts, and TWA is attempting to sell major international routes to American. USAir is having serious financial difficulties. Worst case scenarios see the industry being reduced to three major competitors, American, United and Delta.

The failure of the airlines now experiencing financial difficulties would be the culmination of years of financial problems, exacerbated by industry-wide trends in 1990. These carriers' long term financial difficulties have been attributed to a variety of causes; poor business plans, high costs, high interest costs (some of which was attributable to leveraged buyouts), and competitive advantages of the largest carriers, particularly the advantages of United and American accruing from their domination of the computer reservation systems used by travel agents.

4 - Effects of Reduction in Numbers of Competitors.

A key issue for the Subcommittee hearings will be whether a reduction in the number of airlines now providing service would reduce competition enough so that the public would lose the benefits of deregulation. A reduction in the number of competitors nationally does not necessarily mean that there will be less competition. The key question is whether there will be less competition in individual city pair markets.

Some observers believe that a reduction in the number of competitors will not reduce competition in individual markets. For example, Secretary of Transportation Skinner stated at a recent speech at the National Press Club (January 23, 1991) that

> One thing is certain: consolidation is no grounds for panic. There may well be fewer major airlines in the 1990s than there were at the end of the 1980s. But even if this happens, we have every reason to believe that robust competition will continue. Under a deregulated system of hub-and-spoke networks and low barriers to entry, existing carriers can serve virtually any market in the nation. As a consequence, competition should continue to thrive.
>
> It is likely that, as the industry consolidates further, some of the lowest fares in the market may disappear. All of us, as consumers, appreciate the low fares produced by the almost desperate marketing strategies that we've seen in the current downturn. But we also know that unrealistically low prices are a bad bargain in the long run. Unless airlines are able to cover their costs, they eventually have to go out of business. And right now, there is not an airline in the country that is covering its operating costs. As this chart shows, the U.S. airline industry is estimated to have lost $2 billion in 1990.

Other observers of the industry believe that if there is a reduction to four or five major airlines, these airlines will stake out their separate markets and will try to maximize profits by refraining from strong competition in each other's major markets.

5 - Legislative and Administrative Remedies.

Although some interested persons have suggested that the airlines should be given some form of financial assistance or guaranteed access to fuel, we are not aware of any detailed proposals to accomplish this. Similarly, although there have been general comments that reregulation will become necessary as the industry becomes less competitive, detailed proposals have not yet been developed.

The Department of Transportation has announced two major policies to deal with the industry's financial and competitive problems: policies to encourage more foreign investment in U.S. airlines, and policies to allow weaker carriers to sell international routes to stronger members of the industry. Other suggested approaches for facilitating competition are to increase the regulation of airline computer reservation systems, and to allow foreign airlines to compete in domestic markets. These proposals are discussed below.

a) Foreign Ownership of United States Airlines. The Federal Aviation Act imposes specific limitations on foreign ownership of United States airlines. Under the Federal Aviation Act, a United States air carrier must have at least 75% of its "voting interest" owned or controlled by persons who are citizens of the United States, and the President of the airline and at least 2/3 of the Board of the Directors and other managing officers of the company must be United States citizens. In addition to these specific requirements, the Civil Aeronautics Board and its successor, the Department of Transportation, have interpreted the law as requiring that citizens of the United States must be in actual control of the airline. In implementing this requirement, DOT determines "...whether a foreign interest may be in a position to exercise actual control over the airline, i.e. whether it will have a substantial ability to influence the carriers activities." If so, the airline cannot obtain a certificate as a United States air carrier.

The leading recent case in which the Department refused to find an airline in compliance with the U.S. ownership requirement even though the airline had complied with the specific requirements of the Federal Aviation Act was the case of KLM and Northwest Airlines, decided in 1989. In that case, KLM, a Dutch airline, was found to have the power to exercise control over Northwest when: a) although KLM owned less than 5% of the voting stock of Northwest (the law prohibits ownership of more than 25% of the voting stock) KLM held substantial non-voting stock, giving it ownership of 57% of Northwest's total equity, and b) KLM had the right to name one of twelve Northwest directors and a three person committee to advise on the general management of Northwest's financial affairs. In a consent order, DOT directed that KLM's equity interest in Northwest be reduced to not more than 25% of the total equity; that the KLM general advisory committee be dissolved; and that there be restrictions on the actions taken by the KLM representative on the Northwest board.

Shortly after the Northwest-KLM decision, the Public Works and Transportation Committee reported and the House passed, (by a vote of 301-113) H.R. 3443 which included provisions to give DOT specific legislative authority to follow the policies announced in the Northwest decision. The legislation gave DOT authority to review certain acquisitions of stock and to disapprove any acquisition which "would result in a person who was not a citizen of the United States having power to exercise control over the air carrier." The Committee report made it clear that this provision was intended to enable DOT to continue to carry out the Northwest case policy. After it passed the House, H.R. 3443, was not taken up by the Senate.

Following the original Northwest order, DOT granted several extensions of time for the divestiture of KLM's interest in Northwest. Then on January 23, 1991, the Department granted Northwest's motion for modifications to the original order. Under these modifications, DOT will permit KLM to hold up to 49% of the total equity interest in Northwest including up to 25% of the voting stock. KLM is also allowed to hold stock in excess of 49% if it places this stock in a voting trust. In addition, Northwest is authorized to increase its Board of Directors from 12 to 15, and KLM is be allowed to have three representatives on this Board. The DOT order further indicates that DOT will not allow a foreign citizen to hold the position of Chairman of the Board of Northwest, and foreign citizens will not be permitted to hold a disproportionate number of seats on important Committees of the Board.

In its order allowing these modifications, DOT announced that it had developed a new general policy on foreign control. The Department stated that

> While the facts of each case would have to be reviewed in their entirety, as a general matter, we would not construe foreign equity investment up to these limits [less than 50% of total equity and 25% of voting equity], taken alone, as indicative of foreign control.

On the related question of foreign debt in U.S. air carriers, the Department stated that "absent a default, unless the loan agreement provides special rights to the debt holder that imply control, we do not anticipate treating debt as a foreign control issue."

The KLM order states that the change in DOT policy is based on a reassessment of what constitutes control. The reason given for this reassessment was that in the course of evaluating proposals for air carriers to obtain capital from foreign sources, the Department had

> seen the complexity and international make up of these arrangements increase, new financial instruments emerge, and the inter-relationship of these instruments grow. Based on that experience, we have reexamined our application of the control test in order to reflect more accurately today's complex global corporate and financial environment, consistent with the requirement for U.S. citizen control.

b) Sales of International Routes. In the past few years, financially weak airlines with international routes have been selling these routes to stronger airlines, for prices of as much as $400 million. The first major route sale in recent years was Pan American's sale of its Pacific routes to United in 1985. This was followed by sales of Eastern's international routes, Continental's Seattle/Tokyo route and TWA's Chicago/London route. Most recently, Pan American and TWA have proposed selling extensive trans-Atlantic authority, particularly their routes to London, to United and American respectively, and Hawaiian is attempting to sell its routes to Australia and Japan to Northwest.

The Department of Transportation's policy has been to encourage and facilitate these route sales. In his recent National Press Club speech, Secretary Skinner expressed satisfaction with route sales on the grounds that the carrier buying the route is generally in a position to provide better service to the public than the financially weak carrier selling the route. Secretary Skinner stated that the Department is "exploring ways of streamlining and making more efficient our review of these transactions." The policy he intends to follow is that "where there are no impediments to competition, or where a transaction promises to enhance competition, our disposition is likely to be favorable."

The DOT policy of encouraging route sales has been criticized on several grounds. First, it has been argued that the policy is inconsistent with the government's basic approach to international aviation. Under the Federal Aviation Act, when the United States signs a bilateral agreement permitting a limited number of U.S. airlines to provide service in a international market the Department holds an extensive evidentiary hearing to decide which U.S. airlines are best qualified to serve the route. Allowing route sales seems inconsistent with this approach. Under the route sale policy, the carrier which was carefully selected for the route is basically free to sell the route to the highest bidder. This bidder is not necessarily the carrier which would be determined to be the best qualified to serve the route.

In addition, freely allowing route sales makes it very difficult for smaller carriers to obtain good international routes, and this may increase the competitive difficulties smaller carriers face.

Another problem is that allowing the sale of international routes requires the carriers buying these routes to pay large sums for them. These large sums become a cost of serving the route and are likely to result in higher fares for the public.

Opponents of route sales further argue that the sales allow carriers which received a route at no cost in an evidentiary proceeding to realize substantial windfall profits from selling the route.

c) Allowing Foreign Airlines to Provide Service Between U.S. Cities. Some economists have suggested that a good way to increase competition would be to allow foreign airlines to provide service between cities in the United States. This would require amending section 1108 of the Federal Aviation Act, which now prohibits this type of service, generally known as "cabotage." Authorizing cabotage for the purpose of increasing competition would be strongly opposed by the United States airlines and their employees.

However, some airlines and other interested persons believe that cabotage should be authorized for a different reason: as part of an agreement with a particular foreign country giving U.S. airlines compensating international rights or rights within foreign countries. No international agreements providing this type of exchange have yet been reached. This type of exchange is currently the subject of negotiations between the United States and Canada and is believed that various European countries would be interested a cabotage exchange, particularly after the economic integration of Europe in 1992.

d) Barriers to Entry, Particularly Computer Reservation Systems. As has been discussed, the financial problems of weaker carriers have been attributed in part to structural problems and to competitive advantages of the larger carriers. Last year's legislation authorizing passenger facility charges included provisions to deal with one of these problems, the unavailability of gates and other facilities needed for new carriers to compete at hub airports dominated by one or two carriers. The PFC legislation prevents incumbent airlines from using powers in their contract with the airport to block new airport construction funded with PFCs. The law further provides that PFC revenues may be used to construct gates and related facilities and that these facilities may not be subject to exclusive long term leases or other arrangements inhibiting competition. The legislation also directs the Department of Transportation to undertake a rulemaking proceeding to explore ways of allocating slots at the four slot controlled airports (Kennedy, La Guardia, National, and O'Hare) to facilitate new entry.

Another barrier to competition has been the domination of computer reservation systems used by travel agents by the two largest airlines, United and American. Since the mid-1980s, the Committee has been urging the Department to take strong regulatory action to deal with the CRS problem. DOT has resisted these requests, although Secretary Skinner's recent speech suggested that some further regulatory action may be taken before the current regulations expire next November.

Historically, American and United's domination of the CRS industry have given them substantial competitive advantages. United and American's CRSs have accounted for 66% or more of all revenues booked by travel agents. This has given United and American the power to charge other airlines high booking fees for having their tickets written on a United or American CRS. A 1988 DOT study showed that these booking fees were approximately twice American's and United's average costs.

In addition, United and American realize so-called "incremental revenues" from their CRSs, that is excess revenues resulting from the tendency of travel agents to book on the airline owning their CRS. According to DOT, incremental revenues produce hundreds of million dollars a year for United and American.

The DOT study found that as a result of high booking fees and incremental revenues, American and United have been realizing rates of return on their CRS systems of 60-100% a year. The DOT studies indicate that CRS systems have given American and United substantial additional profits and created substantial added costs for other airlines.

On the basis of these and other studies, some members of the industry believe that legislative or regulatory action is needed to increase opportunities for other CRS systems to compete,* and to deal with the problem of excessive booking fees.

American and United disagree with these proposals and argue that their profits on CRS systems are fair rewards for their investment in a risky technology; that airlines without CRS systems have succeeded (e.g. Southwest); and that the CRS industry is becoming more competitive and less profitable, particularly because of Delta's, Northwest's and TWA's merger of their CRS systems into a new system, "Worldspan."

6 - Expected Witness. (Preliminary) Witnesses expected to testify at the hearing are:

February 5

- Department of Transportation (Secretary Skinner)
- Air Line Pilots Association
- Panel of academic economists affiliated with Northeastern University, Harbridge House, and the University of Denver Law School
- Panel of Aloha Airlines, Alaska Airlines, America West, Pan American, and Northwest

---

*In particular, by restricting clauses in contracts between the CRS owner and travel agents which make it difficult for the agent to switch to another system. These types of clauses include long contract terms, high liquidated damages for termination of the contract, and requirements that the agent make "minimum use" of the CRS system.

February 6

- General Accounting Office
- Air Transport Association
- Panel of investment analysts affiliated with Shearson Lehman Bros. and Standard & Poor's
- International Flight Attendants Association

THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

TUESDAY, FEBRUARY 5, 1991

House of Representatives,
Subcommittee on Aviation,
Committee on Public Works and Transportation,
Washington, DC.

The subcommittee met, pursuant to call, at 9:40 a.m., in room 2167, Rayburn House Office Building, Hon. James L. Oberstar (chairman of the subcommittee) presiding.

Mr. **Oberstar**. The Subcommittee on Aviation will please come to order.

With today's hearings, we undertake a comprehensive review of the condition of the U.S. airline industry. We will explore the extent and causes of the financial distress, the industry is experiencing.

We will also look at whether there is adequate competition, whether any government action is needed, or able, to improve the industry's finances and to enhance competition.

Since the mid-1980s, there has been a steady decrease in the number of major airlines. Of the 22 new entrants since deregulation, in the first eight years, only four survive. The others either failed or were acquired by other carriers or changed to commuter operations.

Between 1985 and 1987, the Department of Transportation approved 10 mergers between major air carriers. As a result market share of the top eight carriers in the industry zoomed from 80 percent of revenue passenger miles in 1978 to more than 90 percent today.

Over the past year, the financial condition of the industry has deteriorated to the point where questions are being raised about the survival of all but three or four major carriers.

In the last six months, the industry has been hit by a triple whammy of a national economic recession, a major increase in fuel costs, and a decline, one might even say, a precipitous decline in international travel caused by the war in the Persian Gulf.

In the last quarter of 1990, the industry's losses totaled $1.7 billion.

For the whole year, 1990, the industry suffered aggregate losses of over $2 billion, making it the worst year in the industry's history.

These losses have been particularly hard on the weaker members of the airline industry. For example, one major carrier, Eastern, totally ceased operations. Two others, Pan Am and Continental, are in Chapter XI bankruptcy proceedings. TWA this past weekend announced it is withholding payment on its debt, and TWA and Pan Am are proposing to sell major international routes to generate cash which they say is necessary, which obviously is necessary for their survival.

Other major carriers incurred record losses in 1990 which they can ill-afford, faced as they are and as the Secretary will testify with the need to service massive debt issued to support leveraged buy-outs.

A basic question in these hearings is what the Government should be doing to assure that we will continue to have adequate competition to preserve the benefits of deregulation.

This Chairman has never deviated from the support of deregulation. Its benefits are clear and have been demonstrated. We need to make sure deregulation works for the traveling public as well as for the industry.

I do have serious reservations in that context about the Government response to date, which seems to be to place much of the blame for the industry's problems on its employees and to follow two policies that may do more harm than good.

Specifically, the Department recently announced a broad policy, not limited to a specific case, which would have been adequate in itself and understandable but a broad, general, national policy of encouraging more foreign investment in U.S. airlines.

Second is the broad policy of allowing airlines who are in serious financial condition to sell their international routes to those carriers with the deepest pockets, willing to pay the most for them.

On January 23rd, the Secretary reversed a policy announced only 17 months ago and decided to allow foreign investors to acquire up to 49 percent of the equity of U.S. airlines. Interested members of the public were given only three days to file their views in the case in which that new policy was announced.

There was no advance discussion with Members of Congress. This is particularly disturbing, since in 1989, this Subcommittee and the full Committee on Public Works reported out and the House passed by a vote of 301 to 113, legislation to assure that the DOT would continue to follow the policy previously announced by the Secretary preventing foreign investors from acquiring more than 25 percent of a U.S. airline stock, reinforcing existing law and codifying the Secretary's decision.

More liberal foreign investment in U.S. airlines should be offered only in the context of a broad policy encompassing our bilaterals and negotiated with our foreign trading partners in agreements where we, the U.S. carriers, and the U.S. traveling public receive comparably valued benefits.

We are deeply concerned about the department's apparent policy of allowing weak carriers to sell their international routes to the highest bidders. That policy raises the question in the first place of why the review process to award an international route that then can turn around and be sold to the highest bidder.

Is the highest bidder likely to be the carrier who can provide the best service on that route?

And how can we hope to have a balanced and competitive industry if only the strongest, most financially secure airlines are free to buy up the best international routes.

Ultimately, isn't the public going to have to pay higher fares to cover the hundreds of millions of dollars paid for those international routes.

Equally, I have strong concerns about the actions the Department has neglected to take. A report issued by the Department in 1988 showed that domination by the two largest airlines, American and United, of computer reservations systems used by travel agents was giving those airlines profits of 60 to 100 percent a year, and imposing added costs of hundreds of millions of dollars on the rest of the industry, as one witness will testify in our second panel this morning.

Although the CRS system has been an important factor in the decline of airline competition, the Department has been unwilling to act. Why?

We do have a diverse group of expert witnesses who will testify at these hearings beginning with the very distinguished Secretary of Transportation. We hope these hearings make a major contribution to the understanding of the financial problems of this industry and help us begin to make some progress toward resolution of those difficulties and keep competition alive and deregulation working for the traveling public.

Last year, in cooperation with the Secretary, we passed the Aviation Safety and Capacity Expansion Act of 1990, far-reaching legislation, monumental legislation, in fact.

This Secretary worked enormously hard to get it enacted on both sides of the Hill and both sides of the aisle. He put himself personally at stake to win the votes, to shape the policies, to chart a new future for aviation. Now we must deal with the financial problems of this industry and again, I emphasize again we must continue to work cooperatively together.

We have a full day, a large number of Members. I will ask that the statements of our chairman and the ranking member of the subcommittee, ranking member of the full Committee, be included in the record.

At this time, the Chair will recognize the gentleman from New Jersey, the distinguished chairman of the full committee, to express appreciation for allowing this committee to be the first out of the box to hold hearings in recognition of the serious problems the industry has and to personally, if I may, for all subcommittee chairman, recognize and welcome our new full committee chairman.

The CHAIRMAN. I thank the distinguished gentleman for his generous remarks. I, too, want to compliment and congratulate him on expeditiously scheduling these hearings. I also want to thank Secretary Skinner for coming here today to testify on these issues.

Mr. Secretary, I know you have put tremendous effort into these airline issues. I am looking forward to hearing your testimony today.

Mr. Chairman, virtually everyone involved with the aviation system today and over the last few years knows that there is an enormous public anger over some of the conditions existing in the system. People are angry over delayed flights, sitting on runways, lost bags and a fare system incomprehensible to all but the best mathematics students.

At the same time, the airlines point to the near doubling of passenger traffic since 1978 and the level of service that is available to millions of Americans and the variety of flights and fares.

I want to, just for the benefit of the Chair and our Members, give a little review of what is happening in my State of New Jersey at the Newark International Airport today.

We have passed through many phases in the age of airline deregulation. First, there was the explosive growth of the discount carrier, People Express, at what was then an under-utilized facility. After growing into an international carrier, People Express became over-extended and was swallowed up by one of the big fish in the airline game at that time, Continental.

Newark has been a Continental base for several years as flights have increased and the airport continued to expand. Now, of course, Continental has filed for bankruptcy protection for the second time.

Finally last week, Continental, after filing for bankruptcy, announced it would add 14 new flights from Newark to points south.

I would like to ask unanimous consent, Mr. Chairman, to place my statement in the record and just close on the point of view that I share your thoughts and concerns, that you expressed in your opening remarks.

I think you have struck the chord that the Members of the Committee are thinking about where the airline industry is involved. If I just can add one vignette that might be helpful.

I had to give a speech in New Jersey the other day. I remember when we left, that it was around noon. We left to get a plane back. There was no two o'clock plane out of Newark, at all, going to the Nation's Capital.

We had to charter an aircraft to be able to get to Washington.

It was only a few years ago, Mr. Chairman and Members of the Committee, that there were three airlines that served Newark and had regular routes on an hourly basis coming back and forth from Newark and the metropolitan area to the city of Washington.

I applaud your efforts. You are right on target. I think you have established the dimensions of the issue, and I look forward to working with you on resolving these matters.

Mr. **Oberstar**. Thank you very much.

The committee recognizes the gentleman from Arkansas, the ranking member of the full committee, Mr. Hammerschmidt.

Mr. **Hammerschmidt**. Thank you very much, Mr. Chairman.

I want to thank you for holding this hearing along with our ranking minority member, Mr. Clinger. It could not be more timely.

As suggested in your opening statement, airline results from last year are beginning to come in. The picture they paint is not a pretty one.

It appears that the airline losses for 1990 will total about $2 billion. This is clearly the worst loss in airline history.

It is more than double the previous record loss of $733 million in 1982.

To the airline industry, it is being squeezed by rising costs and declining revenue. The cost of fuel and labor are higher. At the same time, passenger traffic is being reduced by the recession and fears of terrorism.

In my discussions with representatives of the airline industry, there is clearly concern about the future. They worry that one more problem could push some of them over the edge.

Given the fears of passengers that already exist, just one terrorist incident could scare even more people away from air travel.

Together with my chairman, Jim Oberstar, I was a member of the President's Commission on Aviation Security and Terrorism. I have also attended several recent security briefings by DOT and FAA officials.

I must say I am heartened by what I have seen and heard recently. Although the threat is great, the level of security is higher as well.

As a result, I believe people should be reassured about the safety of flying.

Of course, one can never provide 100 percent guarantee. However, the public perception of the danger seems to be out of proportion with the actual risk.

It is my hope that in this hearing, we will thoroughly examine the current problems of the ax industry and discuss possible solutions. I recognize the problems are complex, the solutions are not easy to come by. But, I am confident the witnesses here today can help point us in the right direction.

I join all of us in welcoming one of the most knowledgable of those witnesses, Secretary Skinner, certainly one of the most energetic and able members of the President's cabinet.

Thank you, Mr. Chairman.

Mr. **Oberstar**. Thank you very much, Mr. Hammerschmidt.

The gentleman from Pennsylvania, Mr. Clinger.

Mr. **Clinger**. As you indicated, Mr. Chairman, today's hearing cannot be a happy one. The combination of recession, high fuel prices, fears of terrorism have indeed left the airline industry on the brink of disaster.

I want to commend you for recognizing the urgency with which we need to address this critical and growing problem by scheduling these hearings at the very outset of the new Congress.

It is very important for us to listen to the industry's concerns and attempt to fully understand their problems, but it is not enough for us to simply sit here and wring our hands.

We have to also look for what could be a proper governmental response, how we can assist in addressing this crisis.

Yesterday, I introduced a bill I think could help.

It would give U.S. airlines access to more capital, specifically foreign capital. Currently foreign investors can own no more than 25 percent of the voting interest of a U.S. airline.

My bill would permit that limit to be raised as high as 49 percent if certain findings are made by the Secretary.

I do not claim that this bill would be a panacea. Perhaps foreigners will not want to invest in a weakened airline industry at this juncture.

However, I think recent history involving Northwest and United indicates there is investor interest and, moreover, I see no reason why airlines should be cut off from access to foreign capital by what I believe is an archaic federal law. Clearly, the need for more capital is abundantly clear.

It is important to emphasize that my bill allows foreign investment only in carefully controlled circumstances. It would not, for example, permit the Japanese to buy a U.S. airline. Only citizens of countries with pro-competitive aviation agreements with the U.S. could invest under this bill.

Nor could an Iraqi or other enemy of this country buy an airline under this bill. Any purchase must be found to be consistent with our national security.

This would also help assure air traffic will still be available to the Civilian Reserve Air Fleet (CRAF), the CRAF program that has been instrumental in recent months in ferrying troops and supplies to the Middle East.

Therefore, I am confident any of the potential problems that have been discussed with regard to foreign investment that could arise are addressed by this legislation.

Mr. Chairman, the airline business, like many others, is undergoing rapid and traumatic change. Airlines are forming all sorts of relationships with their foreign counterparts and this globalization process is the wave of the future.

Investment, I think, is a natural part of that process.

Currently, some nations have liberal investment rules, more liberal than we. If America assumes its traditional leadership role in this area, I am convinced other nations will follow suit and begin to open up as well.

This will help all airlines move into the 21st Century with greater strength and vitality. I am pleased Secretary Skinner has recognized the need for action in this area.

Congress, I think, has an important role to play as well in this process, both in revising the law and in setting the limits and determining the conditions under which foreign investments may be permitted.

It is my hope during the course of this hearing we will be able to discuss the pros and cons of liberalized investment rules as well as other solutions to the problems now confronting the airline industry.

Again, Mr. Chairman, I commend you for taking the lead in calling these hearings and look forward to hearing from our very able and distinguished Secretary of Transportation, Mr. Skinner.

[The prepared statement of Mr. Costello follows:]

OPENING STATEMENT BY HON. JERRY COSTELLO

Mr. Chairman, recent events in world affairs and in the domestic economy have put a serious stress on the U.S. airline industry. We are all familiar with these events: Iraq's invasion of Kuwait; the subsequent rise in petroleum prices; negative economic growth in the last two quarters; and a severe dropoff in domestic and international air travel due to concerns about terrorism. These factors have resulted in the demise of Eastern Airlines, have forced Pan Am and Continental into Chapter 11, and threaten the viability of several other carriers.

The airline industry threatens to become much more concentrated, and this Subcommittee is rightly concerned about a possible loss of the benefits of deregulation. Not only is the field of competitors shrinking, but many of the remaining weaker carriers are attempting to sell routes, thereby increasing the market power of a few strong airlines. Many of my constituents in Southwestern Illinois are concerned about the proposed sale of TWA's London routes, for example.

I welcome our witnesses, and I am interested to hear their perspective on what federal policies can help alleviate any anti-competitive effects of the current financial problems in the airline industry. For example, what role will route sales and slot allocations play in ensuring that various routes are served by an adequate number of carriers? In light of recent initiatives toward an "open skies" policy between the United States and Canada, could increased cabotage privileges balance a loss of U.S. carriers? Should Congress consider reregulation at some point?

I look forward to an interesting a productive discussion. Thank you, Mr. Chairman.

[The prepared statement of Ms. Horn follows:]

OPENING STATEMENT OF

HONORABLE JOAN KELLY HORN

for the February 5, 1991 hearing on

THE ADEQUACY OF COMPETITION IN AND THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY

Mr. Chairman, fellow Subcommittee Members, and distinguished guests:

The importance of these hearings today on the financial condition of our domestic airline industry cannot be overstated. The gravity of this situation is moving closer and closer to home for many of us. It has certainly reached the Second District of Missouri.

Just yesterday, the City of St. Louis took action in the U.S. Court of Appeals against a decision by the Department of Transportation allowing the sale of TWA's Chicago-London route to American Airlines. This route sale is the first of seven applications by TWA for DOT route transfer approval. The City, with the support of a consortium of business, labor, and government representatives, views this sale as a serious mistake that is likely to facilitate the dismantling of TWA piece by piece. I share this concern, and would like to emphasize a need to focus our efforts in this subcommittee on ways to revitalize the industry and avoid further concentration. I would like to get Mr. Carl Icahn's viewpoint on how we can approach this with TWA. Unfortunately, neither he nor any other TWA spokesperson is here today. I will question Secretary Skinner about the route sale in more detail at the appropriate time.

We have witnessed a decade of highly-leveraged buyouts which has left us with an airline industry even more concentrated than before deregulation. I am afraid the industry will shrink even further. The people in my district are closely watching the developments in the airline industry. They are concerned about the workers who have served the airlines well who may lose their jobs, and they are concerned about future access to airline service at competitive prices. Therefore, a central question I hope this hearing will address is how to prevent an uncompetitive oligopoly in the airline industry. We must ensure that further airline concentration will not deny consumers access to affordable and safe air transportation.

It is not clear to me why only four of the twenty-two airlines formed after deregulation were able to survive. Between 1985 and 1987, DOT approved 10 major mergers either resulting from or resulting in major debt burdens on the involved parties. The fourth quarter of 1990 alone saw the industry lose $1.5 billion dollars. Has this trend toward large consolidations and indebtedness been good for the industry overall? I hope our witnesses today address this question.

I realize that the recession, and threats of terrorism because of the Gulf conflict, have discouraged air travel. This decline in ridership has been a blow to the already overleveraged industry. But even before the conflict spurred speculation and oil-hoarding that drove jet fuel prices up 100% in a six month period, the airlines were in trouble.

We have seen Eastern – one of the pioneers – close its doors. Pan Am and Continental are both operating under Chapter 11. They both sought to survive by selling vital international routes. That strategy has been unsuccessful. Northwest would also be gone today if DOT had not allowed its rescue by the Dutch airline, KLM.

I am clearly concerned about the future of TWA, and consequently, the future of adequate air travel through St. Louis. Mr. Icahn has proposed that TWA sell its valuable international routes to raise operating capital. Yet, none of the capital raise through the sale of other TWA assets has been used for improvements in the airline. This issue concerns me greatly.

In conclusion, I want to thank Secretary Skinner, the airlines, the unions, and other industry experts for appearing before the Subcommittee today. Your interest and your advice is welcome and appreciated. I look forward to working closely with all of you in the months to come.

Mr. **Oberstar**. I would like to say at the outset I very greatly appreciative of the splendid participation and cooperation from my colleague from Pennsylvania, Mr. Clinger.

All throughout the 101st Congress on many complex issues this subcommittee faced, we worked together many, many hours. We had disagreements. We always worked them out.

They always came out in the best public interest. I look forward, again, to a very productive Congress working with Mr. Clinger, and may I say also Mr. Hammerschmidt, not only our participation on the President's Commission, but your active participation on this subcommittee.

I think we will be joined in this Congress by the Chairman of the full committee. We will have a very lively, effective two years.

Mr. Secretary, welcome again to the Subcommittee on Aviation.

Let me reiterate my great appreciation and respect for your leadership on aviation issues, for the participation, partnership—participation you gave personally and the partnership we developed throughout the last Congress on many far-reaching, complex issues.

Again, I believe they came out to the overall, long-term benefit of aviation.

I look forward to your vigorous participation again.

You are a person of individual dynamism, good ideas, strong leadership, occasionally we will have differences as we have this morning on policy issues.

I expect as we did in the past we will discuss them frankly, openly, without reservation and go on to reach solutions.

Thank you very much for being with us today.

TESTIMONY OF HON. SAMUEL K. SKINNER, SECRETARY, U.S. DEPARTMENT OF TRANSPORTATION

Secretary **Skinner**. Thank you, Mr. Chairman.

My advisors would probably tell me after that to go home.

Let me, first of all, publicly thank you for all the work you did last year on helping us on a bipartisan basis pass the most significant piece of aviation legislation since deregulation, and thank the many members of the committee who were so intimately involved including, of course, Mr. Clinger, Mr. Hammerschmidt, and many of the others I see throughout this room.

When we finished that process late in the evening, as the Budget Act was passed last year, I thought this year would be the year of surface transportation and most of the major challenges in aviation would be over.

How wrong I was.

I find, because of a variety of circumstances which we will discuss briefly, the activity at the Department in aviation is probably as intense as it ever has been, and just as I did last year, I welcome the support of the committee and especially the chairman and the ranking member of the Subcommittee on Aviation as we work through these very difficult issues.

I can say with an absolute degree of certainty that, had Chairman Oberstar, with Mr. Clinger's assistance and many of the members of the committee, not been willing to put the extra effort into the legislation last year, we wouldn't be where we are today as far as aviation capacity and noise.

It was really a bipartisan effort in the highest traditions. That would not have been possible were it not for your leadership.

To Chairman Roe, although you are not new to the committee, you are a new chairman. I think it is appropriate that one of your first official duties is to participate in and attend this significant hearing.

I have prepared remarks I would like to introduce and make part of the record.

Mr. OBERSTAR. Without objection, your entire statement will be included in the record.

Secretary SKINNER. I would make brief observations and entertain questions.

The airline industry is going through a very difficult period. I don't have to tell members of this committee just how difficult it is, but last year's loss is estimated to be $2 billion, which is the greatest one-year loss in the industry's history.

Of course, as a result of this loss and the fact that most of this loss appeared in the last quarter of 1990, we have seen a flurry of proposed transactions among airlines.

Before we discuss the current situation, I think it is important to recognize where we are from an overall perspective.

This Department for the past two years has been working to develop a policy and put it into place to address many of the challenges that we found as we assumed office two years ago.

All of you should have by now received the Aviation Competition Study conducted by the Department, which was the most comprehensive study on airline competition ever conducted.

That clearly demonstrated that airline deregulation has resulted in substantial benefits for travelers. Generally—absent the last several months—the airline industry that has been growing, and that has resulted in substantial benefits for travelers. For example, in the month of December, over 90 percent of the people traveling in aviation were traveling on discount fares, something unheard of in the era of regulation.

Sixty-five percent more people used the aviation system in this country than prior to deregulation, and, yes, this weekend travelers will be traveling all over this country as a result of discount fares as low as $160 round trip to some of the major places in this country.

As we look at the very difficult problems the industry faces, we must recognize the consumer has benefitted over the period of deregulation in a substantial way.

There is no question that the Aviation Capacity Act of last year dealt with many of the concerns that were expressed in the aviation competition studies.

Thanks to this committee and the effort of Chairman Oberstar and others, passenger facility charges will be available to airports so they can expand capacity. The system in this country works in a deregulated environment when all airlines can compete free and openly with each other and have full access to airports, gates, runways, and air space. Passenger facility charges will go a long way towards that end.

It will add capacity by providing billions of dollars to the aviation system of this country, and at the same time, of course, will deal with the very thorny problem of noise.

The industry in the long term continues to have potential not only for deregulatory benefits but for growth.

Consolidation is going to occur. It was inevitable that it would occur and the current situation over the last several months has accelerated that consolidation.

Consolidation in and of itself is no grounds for panic. Clearly, it is no grounds for turning back the clock on deregulation. Consolidation works when the major consolidated airlines compete against each other on a head-to-head basis as the capacity and demand warrant.

As I have said, passengers are enjoying more service and more frequent service generally—New Jersey notwithstanding—and, in fact, air travel has increased, as I said, by 65 percent while real air fares have declined 28 percent since 1981.

That brings us to February 1991, when the airlines are going through the final stages of consolidation and restructuring. This, of course, began in the late 1980s. Several factors have recently combined to accelerate the process and make this a most difficult time.

The slowdown in the U.S. economy. There is no industry in this country, with the possible exception of the automobile industry, that is more susceptible to a downturn in the economy than the airline industry. Air travel is the first thing to go; and instead of flying, people drive or don't go at all.

The cost of jet fuel increased dramatically from the period August 2 to the early part of January. That higher cost of jet fuel was the most significant increase in history. It was in many respects unwarranted. Now that the system understands that jet fuel is plentiful, the airlines inform me that jet fuel costs are under control. I believe that with the pipelines full, with the period of increased demand coming up in the spring, that the jet fuel problem as to price and supply is beyond us, but it has taken its toll.

There is no question, as Mr. Hammerschmidt indicated and as the Chairman knows from his participation on the Commission, that the threat of terrorism or the alleged threat of terrorism is having a very, very dramatic impact on the aviation industry.

While there are general threats of terrorism, as I have indicated before, the level of security both domestically and in foreign airports has never been higher. And the United States and its partners throughout the world have never been more vigilant. The system is safer than it has ever been before against the threat of terrorism.

Unfortunately, that message is not getting across to the American people. It is not getting across to American businesses. Some of the biggest businesses in the world have opted to cancel travel, many without any basis, and are canceling travel not only to areas that might be susceptible to a slight increase in the threat of terrorism, but are canceling travel on a global basis to places where there are no real threats of terrorism at all.

That has created a major problem for the airlines, a problem that is somewhat beyond their control. It appears to me that if in fact we are going to maintain this country and this economy, especially when we have the level of security that we have throughout this country, we cannot let the threats of one person halfway around the world destroy the aviation industry.

So I welcome the opportunity not only to inform this committee of the level of security, as I did with the House Foreign Affairs Committee last week, but to urge Americans, especially people in the business/corporate world, to realistically assess what is going on, the fact that the protection levels are there, and, rather than discouraging travel domestically and internationally, to encourage such travel in the normal course of business.

I think once we return to that level of travel, a significant part of the problem of revenue flow to the airline industry will disappear.

It is quite clear that some airlines have never quite adjusted to the rigors of the marketplace and have suffered accordingly. Many of the airlines in trouble today are the same airlines that were in trouble 25 years ago.

One of my associates in the administration reminded me that when he served on the Civil Aeronautics Board 25 years ago, two of the airlines that were currently the subject of discussion moments ago, TWA and Pan Am, had applied for emergency relief before that board to get them through a very difficult period of time.

The deregulated environment is different than the regulated environment. The companies that survive are the companies that make that adjustment. Some have had a more difficult time than others. There is no question as this consolidation occurs and as the costs go up that the costs of aviation travel will increase. Last month, no major airline in the United States met its operating costs. Each airline's costs exceeded its revenue on an operating basis. No business—whether it be an airline business or a biscuit business—can continue at that level.

So when the fares do go up—as they will—it is important to recognize that the airline industry has a right to recover its costs and return investment to its shareholders in a normal way.

I suggest that many of the problems we face today through this consolidation period are problems that existed for many years, and that the airlines have not yet come to grips with them. In particular, I discuss the issue of labor costs, which are not under control at most airlines—increasing labor costs that once were passed on to the consumer in the regulated environment, and were one of the major reasons for deregulation.

And I suggest the airlines and the industry as a whole must come to grips with the idea that it may not be appropriate for one airline to pay twice what another airline is paying for the same level of pilot or the same level of crew or the same level of travel reservation agent. The free marketplace must determine the appropriate wages, appropriate salaries, and benefits. That is how the deregulated system works. That is what the Congress of the United States intended to happen when they passed the deregulation bill.

I believe management and labor must work together in recognizing not only the short-term problems but the long-term problems and benefits. Many of the airlines that have had problems in the past have had problems because management and labor have let the situation get out of hand to a point where it has deteriorated to an unacceptable level. There is no question that the distortions that we have talked about, all of the distortions, have created an unhealthy environment for the consumer.

I believe that as we go through the restructuring, we will have a healthy, enhanced aviation system and that just as the Air Transport Association predicted, while this year will be a level year for the industry, that next year should be a good year and we should see a return to profitability.

In the meantime, it is incumbent upon the Department to do everything he can to take aggressive steps and enhance competition; to make sure that we have as many competitive airlines all over the world as we possibly can; to make sure the decisions we make are not only not anticompetitive but are pro-competitive.

We recently announced—as the Chairman pointed out—a new policy changing somewhat the restrictions on foreign investments in U.S. airlines. This change in policy was made after an opportunity to visit the KLM-Northwest situation for a period of time and to assure ourselves that no foreign investor controls Northwest Airlines.

It did not involve a change or departure from the current statute under which the Department operates. It refined the definition of "control" by re-examining the factors that would be weighed in determining control of an airline by a foreign capacity. And as we said in that statement announcing our change in the KLM decision, each transaction must be analyzed on its own merits. Even though total foreign equity investment up to 49 percent will not on its face be indicia of foreign control, the companies must adhere to the other foreign ownership and equity and voting stock requirements of Federal law and must prove beyond any question that they continue to be U.S.-owned and U.S.-controlled.

At the same time, this policy change was made after consultation with the airline industry and many individuals in the regulatory process, although on a somewhat abbreviated basis, because when the airline industry came to me after the Desert Shield operation began, they suggested a number of things that could be done; and relaxing restrictions on foreign investment was one of those recommendations that, while not receiving a unanimous recommendation from the industry, received solid support and more support than most.

It is an attempt by this country and the airline industry to attract foreign investment into the U.S. airline industry so that we can rebuild the capital structure of the airline industry of this country, so they can enhance competitiveness and participate on a global basis.

There is no question as we move forward that the airlines of the future, the great airlines of the future throughout the world, are going to be global in nature, are going to be multinational in nature, just as the major corporations of the world are today.

At the same time, we must do everything we can to remove barriers to entry. We have pending right now a proposed rule that will address long-term gate leases, and will propose a rule on new entrants gaining access to the four slot-controlled airports in the country.

I would suggest to Chairman Roe one of the problems we have with capacity at Washington National, as I am sure he is aware, is the fact that the capacity at Washington National is restricted by statute at a level less than what we are able to handle on the ground and through the air traffic control system. That is an artificially capacity constraint which, if raised to its full potential, could add a substantial number of flights from New Jersey and other parts of the United States.

We are proposing a rule to eliminate the anticompetitive practices involving computer reservation systems, and I can assure the Chairman that that rule will be coming forward. It is one of the more difficult rules we have had to face, but we are not unmindful of our mandate to proceed. We continue to explore the concept of cabotage as well as our successful cities program to encourage international airation.

I would suggest the airline industry is faced with difficult problems; but had we not broadened our approach at the Department and in the administration and through the Congress to allow U.S.-flag carriers to compete globally, the situation would be much worse. Much of the revenue loss in the United States has been offset at a number of major carriers by revenues at least through the end of last year in foreign operations. Many airline executives have told me the future of their airlines on a global basis will depend upon their ability to participate and compete in open markets throughout the world.

Those are things that we are taking a very active role in dealing with.

I welcome the committee's advice and counsel as I have in the past. I do not pretend to know all of the answers, nor does anyone in the Department. The problems we deal with are some of the toughest and most perplexing that the administration faces at this time in the domestic arena. Although I am satisfied and pleased with the level of counsel I get from my own people—and of course I am not short of advisors from the airline industry, whether I want that advice or not—I welcome the opportunity to participate and explain what we are doing, why we are doing it, and welcome suggestions from you on what we should do and why we should do it.

Thank you very much.

[The prepared statement of Secretary Skinner appears on p. 361.]

Mr. Oberstar. Thank you, Mr. Secretary, for your thorough review of the issues we have to deal with and for addressing those matters that are of critical importance to the airline industry.

I have a question. If Delta Airlines owns 5 percent of Swiss Air and Swiss Air owns 10 percent of SAS, and SAS owns 18 percent of Continental and 9.9 percent of Texas Air, what percent of Eastern does Delta own?

Now, if you had your calculator and had been able to answer that, it would have been a difficult question to answer.

Such is, as you have addressed, the new math of post-deregulation mergers, consolidations and failures in the airline industry. In the European airlines, they look first at the U.S. model for deregulation, then at the onset of post-1992 Europe, began to create global partnerships. That is what we are having to face and deal with.

So my concern with the policy interpretation, if you will, that you announced recently is that it was done sort of on an ad hoc basis rather than in the context of a negotiated broad policy with our competitors. I favor an open skies regime in airline trade and investment. I think your initiative last fall with Canada and with Canada's minister of transport, Douglas Lewis, is a very solid initiative. This subcommittee spent quite some time in Canada reviewing options for expanded trade, including cabotage between Canada and the United States.

The European Economic Community a year from now will be a different regime with a single internal market within which they have not yet resolved how to deal with cabotage. We should be negotiating a broad policy. I think there are significant benefits for U.S. carriers. My concern is doing it on an ad hoc piecemeal basis.

Now, your statement this morning is somewhat different or shows a shade of difference from the announcement earlier on the KLM-Northwest matter. Then you said, as a general matter, speaking to foreign equity investments; this morning you say we are doing it on a case-by-case basis. Which is going to be the policy for the future?

Secretary SKINNER. I believe that in my speech to the Press Club, two weeks ago tomorrow, I indicated we would continue to look at each transaction on a case-by-case basis; but that in general, because the interpretation of control is determined by decisions at the Department and there was precedent for such a decision, that we wanted to use this decision to inform anybody who might be investing what we had in mind.

Every case has to be considered on a case-by-case basis; but generally the investor ought to know how we are going to consider this issue before they go forward with the transaction.

Chairman Oberstar, I share the feeling about how we would like the world to be and how we believe frankly the world will be. Unfortunately, the world as we find it today is still on a bilateral negotiating basis. It is a very frustrating process. It is frustrating in the case of our negotiations with Japan where we thought we had negotiated, for routes and for access to the airports where those routes would go to, and yet found ourselves in a very complicated process of negotiating for slots.

I am hopeful that that will be resolved this month.

We are in the process of negotiating with the United Kingdom on access to Heathrow on a general basis, an airport where the British government dictates what carriers may fly there. That is antiquated. That is, in my opinion, no longer appropriate; yet I find that process to be an extremely difficult process.

Our partners throughout the world don't agree with your and my interpretation. Many of them are afraid of competition. They are afraid of our airlines. I think that is especially true in the United Kingdom. The issue of what role the aviation market will play in the European Community will be determined by the commissioners and their countries sometime this year.

There is a wide difference of opinion among the countries as to what that role should be. Unfortunately, there are a number, including the United Kingdom, that are hanging on to the vestiges of a controlled environment.

Mr. **Oberstar**. You have described the situation very well. You certainly have underscored the situation with Japan where, incredibly, Japanese want us to pay each time for rights that we have already negotiated and paid for. Similar negotiations with the European Community (EC) are not quite so difficult, except in the case of British Airways at Heathrow; but what my concern is is that in changing the investment regime, dealing with Air France, a 100 percent government-owned; Lufthansa 52 percent government-owned; Alitalia, 83 percent government-owned; Iberia, 100 percent government-owned—I won't go through the whole list of all the EC member airlines that are government-owned who want to invest in U.S. carriers—raising some security considerations, policy questions of a broader nature.

I don't question the need of Northwest Airlines for the investment capital and the need to be freed from the burden of debt that the original decision imposed upon them, which was a good decision. When you sat before this committee, we praised that decision. It was a good one. Still is.

What I question is so abruptly making a decision on that case and saying it is a broad policy for all future cases.

Secretary **Skinner**. Let me just say, number one, that these are very difficult times and the airline industry has asked for a quick response in these difficult times. These are not normal times. I felt obligated to do what I could because many of the problems they were facing were problems that were beyond their control.

One of the things that they asked us to consider as a step to replenish the capital they had lost during the period August 2 to the end of the year was to relax without losing U.S. control of airlines, the foreign investment restrictions. We also then had an occasion with Northwest that allowed us to redefine control in that leveraged situation, which was the first of its kind. They had pending before us an application, and we had already given them a deferral because of the crisis that existed.

So it was a little fast—but I can assure you that it was not without a lot of thought and that it was an attempt by us to assist this industry in a very difficult time.

Mr. **Oberstar**. I will have some questions about route sales and the process of policy involved in those when we have the second round of questioning.

When is your rulemaking on the buy-sell matter at slot-controlled airports going to be available? I think that buy-sell rule, not initiated under your—it predated your tenure in office—has worked in an anticompetitive matter, as the recent auction of Eastern's slots at National has demonstrated. Only the deep-pocket carriers are able to buy those slots. Carriers that might serve from Chairman Roe's state of New Jersey into National don't have the deep pockets.

There should be a national policy that looks at those competitive questions and that makes a broader determination than pure market forces, that is those who have the most money to pay for those slots.

I hope that you will be—that your forthcoming rulemaking will address that issue.

Secretary **Skinner**. Well, it will address that issue. It is something we have been working on. The statutory deadline, of course, is July 1. But it will be out before then. I meet on it every week.

Slots are a very difficult and frustrating problem. I have before me the results, which were handed to me as I got in the car this morning, of the Eastern auction. Some of these results are in my opinion very disturbing.

As we speak, my people and the Department of Justice antitrust people are working on it. We advised the court that just because those transactions appear to award slots to the highest bidder does not mean that these transactions will be approved. I think this is an opportunity to deal with the problem of access for new entrants and pro-competitive carriers, and we ought to take advantage of it.

In some cases, however, one case in particular, not a slot controlled airport but the facilities at Atlanta, only one carrier made a bid. Of course, that is very disturbing because that will give the one carrier, as good as they may be, full control of concourses A and B at Atlanta. That transaction is being looked at.

This Department and the Antitrust Division have taken a very pro-active position in analyzing these transactions; and the Department of justice has rejected transactions as the Chairman knows, in some cases.

Mr. **Oberstar**. I compliment you on your view and the statements you have just made and this committee will help in every way that it can.

The Chair recognizes the Chairman of the full committee, Mr. Roe.

The **Chairman**. I agree with the salutations being expressed today for Secretary Skinner. I happen to think he is one of the most knowledgeable people in the country in the overall transportation program, and has manifested that in the effort he has put forth.

I happen to agree with the Secretary that we should be talking globally about the competitiveness of the American industry. This doesn't only hold true just in the airline business, but it holds true for the overall transportation program. The American industry, in order to be competitive, must recognize and stand up as global leaders.

Having said that, however, I am not impressed, when you state on page 4, that the United States airline industry has grown by 65 percent since deregulation. And last month, only 92 percent of air travelers flew—almost 92 percent of air travelers flew on discount fares.

That simply says to me that the airlines didn't market properly because if 92 percent went on discount fares, then that was what the marketplace was going to provide. So I don't think that says really very much to us.

I think the Chairman was developing a concern for this foreign participation in ownership. We have all kinds of concerns, because basically this administration comes back and says, "We have winners and losers where industry is involved, and what we really should have is a program where the marketplace decides."

And then, if I may add one more codicil, on page 10, the bottom paragraph, you come back and say, No. 3, and I quote, "We intend to take a close look at the policy of granting antitrust exemptions which permit airlines, both United States and foreign, to enter into agreements that fix the price of travel to and from the United States."

Well, I would simply like to say, without going further in this dissertation because there is not enough time this morning, is that that whole gamut of price fixing raises concern particularly when we talk about international ownership of American airlines. That bothers me.

I need one more minute. That is one of our rules. I don't think I had five. I think this Chairman shorted me.

Mr. OBERSTAR. The machine has short-circuited.

The CHAIRMAN. The Chair will see that that machine is fixed.

What I am trying to say is that we take a very serious look at this. I am just not so sure that we should be opening our ownership in American airlines.

Something has got to be fundamentally wrong if 95 percent of our airline fares are discounted. If American capital cannot support its own airlines, then I don't think we necessarily should have to look to the international marketplace to provide that capital. Something is fundamentally and basically wrong with that premise. And I think we have to take a very, very serious look at that, and particularly if we get to the point of determining where we go with an antitrust exemption, allowing those same airlines to fix a rate for people traveling back and forth to Europe and to Asia.

So I would hope, Mr. Chairman, we have an opportunity to get into this in some more depth. That is the policy that bothers me the most in the Secretary's presentation.

Secretary SKINNER. I will be more than glad to give you part of my time, Mr. Chairman.

The CHAIRMAN. I would like that time on the 20th when you are back again.

Secretary SKINNER. Let me make a couple of observations. First of all, the airline industry had a pricing policy which recently, because of an overload of capacity and a lessening of demand, when combined with the fact that at least one carrier, Eastern, was flying, with a subsidy from secured and unsecured creditors. Resulted in them offering prices and seats at below their cost in order to keep those airplanes full. That period will be over shortly and you will see that that won't reoccur. But in the meantime, the consumer has benefited and we will find some level where the consumer will still benefit, but, perhaps not that much.

I share your concern, and we have never suggested that in the process of attracting foreign capital, including foreign airline capital, that U.S. flag carriers give up control, and that they not continue to be U.S. owned. All we are suggesting is there be greater synergy, and that non-citizens can invest to a level without taking over an airline. Because they access route structures in parts of the country, while others access route structures in other parts of the country, there can be synergy in marketing even though there is no control.

And I would suggest in the automobile business, one of the mainstays, up until this year and probably this year for General Motors and Ford, is the fact that they have participated in similar synergy in the European markets.

Having said that, we are not suggesting that foriegn airlines be permitted to control U.S. airlines. On the pricing situation, what we are suggesting is currently we have given an exemption to IATA. Even we favor open markets in this country, many other countries and their airlines do not, and IATA has received from our government antitrust immunity to do exactly what you and I are discussing which is fix prices.

We are suggesting it is now time for us to reassess where we should give that exemption. And the Antitrust Division at Justice is doing that. If, as we are considering, we remove that there is no exemption, then those airlines would be required to price in the open market or face antitrust enforcement.

So I think we are moving in the direction that the Chairman suggests, by looking at whether or not that exemption from antitrust prosecution is still essential. And there is a strong body of opinion that says we should leave those carriers to the open market rather than a regulated market.

Mr. OBERSTAR. Secretary Skinner, in order to attract foreign capital, as you state, you mentioned there ought to be foreign membership on airline boards. I think if we are going to consider this, there ought to be a question of reciprocity between nations.

For example, J. Boone Pickens could write a book on this subject matter. If, in fact, a Japanese firm wants to become a member of our board, there ought to be a reciprocity between our nation and their nation.

Secretary SKINNER. Well, we agree. In fact, in my speech I indicated that we should open both markets for investment. In synergies and opportunities, there must be access in the foreign market.

Congressman Clinger's bill goes beyond what we have done in the department, and suggests exactly the same thing.

Mr. OBERSTAR. The gentleman from Pennsylvania, Mr. Clinger.

Mr. CLINGER. Thank you very much.

Thank you, Mr. Secretary, for your always candid and helpful testimony.

In your testimony, you indicated that there was a determination, before making the determination in the Northwest-KLM situation, that there was insufficient capital available in the United States. Was that based on some sort of a study or how did you make that conclusion that there really was insufficient capital here to address the problem?

Secretary SKINNER. I held two series of meetings with every CEO in the airline industry in this country, I think without exception. And in those two meetings, they all informed me that they were unable to attract capital in this country in any significant way.

I also held a lunch or meeting, and I lunch with analysts from the industry, and they indicated to me that there was not the amount of available capital and interest in the United States.

I also recognize, having heard many people throughout this country, that the available equity and debt capital today in this country from our financial institutions is substantially less than the demand, and that one of the biggest complaints I get, as I travel all over this country, is that the American financial institutions and traditional sources of equity and debt are very reluctant, because of the savings and loan problems and other things, to make the kind of loans they traditionally would make. And that is a common thread I hear, whether it be real estate or the auto industry—I was in Detroit last week talking to the three major automobile manufacturers and their suppliers.

Sometimes long-term suppliers who have supplied these companies for 30 and 40 years, who have obtained lines of credit without default for 20 to 30 years for working capital from banks in this country, no longer can get those loans, even though they have no default record. They are then asking the auto companies for the first time in years to loan them money. There is just a shortage of equity and debt capital right now in the U.S. market.

Mr. CLINGER. You indicated this was a pretty generally held recommendation on the part of the industry, but there were some who were not. What was the basis of their concerns?

Secretary SKINNER. I think the basis of their concerns was that they did not have the presence in the international markets nor the intent to compete in the international markets, and that most of the carriers, the several carriers that objected, felt it would put them at a competitive disadvantage, or they had their capital structure in place already, had no need to go out for capital, and that that would put their competitors in a little bit better position.

You know, this is an industry that is very competitive. All you have to do is see them compete against each other to recognize that, even in Chicago where American and United compete against each other. They don't like to give each other any kind of edge, competitive edge, in any way. So in any situation like this, you are going to have some differences of opinion because of the competitive nature of the industry.

Mr. CLINGER. In the new policy you announced a couple of weeks ago, you would permit up to 49 percent of foreign equity ownership but at the same time holding the line in terms of voting interest. If in fact some of the conditions that are contained in my bill were to be included such as the ability of requiring pro-competitive agreements or reciprocal investment levels, in other words, equality on both sides, would that in any way change your feelings about allowing a higher degree of voting equity interest?

Secretary SKINNER. Well, Congressman, I know the process, so I have prepared remarks regarding your bill at this point.

Mr. CLINGER. I thought you might.

Secretary SKINNER. And I quote: "You are to be commended for addressing the different basic issues involved in keeping our carriers competitive."

Mr. CLINGER. I would have hoped that would have been spontaneous.

Secretary SKINNER. "This bill seems consistent with opportunities for foreign investment." The DOT staff will need time to analyze it before taking a formal position.

"I look forward to working with Mr. Clinger and the rest of the industry in keeping our airline industry competitive throughout the world." Having said that and doing my duty, I do sincerely applaud you for focusing on this issue. I think that is one of the issues that the Chairman wants to focus on.

I bit off a big chunk, as you can tell from the comments already made today. I am delighted that someone else has taken another chunk, and I am anxious to see if we can digest it.

Mr. CLINGER. As the Chairman and I indicated, I think it is important that the Congress be a player here. We are all interested in achieving the same thing, which is a healthy airline industry.

Secretary SKINNER. The red light is on, but I am going to take my 30 seconds from Chairman Roe that he didn't use.

In the long run, next century, like it or not, we are going to have a global airline industry, and those that survive are going to be global in nature, multinational in nature, serving points all over the world that today are unserved. And if we are going to play a role in that, we have got to develop the synergies. We have got to be ahead of the power curve. We have got to stay current.

Thank you.

Mr. CLINGER. Thank you.

Mr. OBERSTAR. I agree, Mr. Secretary, and I address the matter of globalization of the industry. I think in developing policies to fit the globalization, we and your department need to look at how merger mania among global carriers, is going to affect the frequency of flights, the choice of routes, the price of tickets.

Secretary SKINNER. I agree.

Mr. OBERSTAR. The gentleman from Missouri. We welcome a new Member to the subcommittee. We are glad to have you aboard.

Ms. HORN. Thank you for the opportunity to be here.

Secretary Skinner, let me mention to you that I represent the district in Missouri, TWA's hub, so we have some very special concerns today.

Just yesterday, the city of St. Louis took action in the U.S. Court of Appeals against a decision by your department which allowed the sale of TWA's Chicago to London route to American Air Lines. This route sale is the first of seven applications for DOT route transfer.

You just mentioned again, as you had in your prepared remarks, the global nature of the airline industry that we are looking at and that is going to come about. I would like to try to reconcile these matters for us on the committee by touching on two points.

What does current law require you to consider with regard to an airline's future viability subsequent to a route sale or merger, and how do you enforce that?

And then, secondly and more specifically, in approving the sale to American of the Chicago to London route, what viability factors on TWA's part did you consider, and was it your understanding that the cash that TWA received will be applied to current debts or improving domestic operation?

Secretary SKINNER. Well, Congresswoman, let me say welcome to the committee and I am well aware of your interest already in Lambert and TWA, as I am.

Number two, if I can, I would like to give you a detailed analysis of those factors that we analyze and why we approved it. This is not a transaction that we went out and sought. This was a transaction that was presented to us.

TWA is one of those carriers that has been in trouble for 25 years. It is one of those carriers that 25 years ago, before the Civil

Aeronautics Board, sought emergency relief to stay alive. It is one of those carriers that is struggling for its life, and last Friday defaulted on, I think, some $60 million in debentures.

Mr. Icahn and his airline are losing cash at a multi-million-dollar rate per day, and they have especially been hurt by the drop-off of trans-Atlantic traffic as a result of Desert Storm.

This airline, in my opinion, is one of those airlines in the area they serve that is essential, and we ought to do everything we can to keep them a viable competitor in the marketplace.

They made a case, a strong case, that without financial assistance provided by the transfer of these routes, they would file for Chapter 7 liquidation, and the thousands of employees that live and reside in your district, and some of them in my home state, would be out of work. It was analyzed thoroughly. The information was provided in great detail. It was analyzed by experts, and we became convinced that the success of TWA as a viable carrier was going to be determined by their ability to retain and raise cash at this very difficult time.

I would also suggest, as you look at these issues, as a Member of the committee, that TWA is one of those airlines that would benefit from an influx of foreign investment and foreign capital, that if in fact they need cash and capital to ride out this difficult time, that they could take advantage of the interpretations that we have made to survive and stay ahead. Literally, as was indicated by the action taken Friday, even though the cash was made available, they still were unable to pay on their debt.

This airline and its network is vital to competition in this country, and we are doing everything we can to continue to make them viable.

Let me say that the transactions between American and TWA in the bigger case, in addition to the Chicago route transfer, are equally important and essential to the vitality and continuation of TWA. They are making that case now, so I won't comment a whole lot, because the record isn't in. Frankly their submission is incomplete. It is a different transaction. It is not one we take lightly. And we balance the needs of the individual airline and the needs of the international market.

And, of course, we had a major setback last week in London when the negotiations went backwards instead of forwards on the substitution of carriers at Heathrow Airport. Without that approval, neither Pan Am nor TWA, according to what they tell us and which we verify, will survive.

So we are doing everything we can to assist the employees of that airline as well as that airline.

Ms. HORN. Mr. Secretary, I appreciate that, and I do look forward to meeting with you and your staff to learn more about that.

Secretary SKINNER. Thank you.

Mr. OBERSTAR. The gentleman from Arkansas, Mr. Hammerschmidt.

Mr. HAMMERSCHMIDT. Thank you, Mr. Chairman.

Mr. Secretary, I think that one area that needs to be discussed in this debate, and this is a proper forum to do it, I think, is safety. I note in your statement that you said that economic deregulation is not the measure of safety; as confirmed a few weeks ago, accident and fatality rates have declined steadily since the 1960s. 1990 was one of the safest years ever. However, with airlines losing $2 billion, I am sure the public worries about maintenance and will it continue the proper course, and will the margin of safety in the industry not decline.

So my question to you is, has the FAA been directed to make sure that the airlines are conducting adequate maintenance programs?

Secretary SKINNER. Yes, they have. In fact, when an airline goes into what we call a voluntary or involuntary bankruptcy situation, we intensify the effort and scrutiny on safety, and that is what we did with Eastern Airlines. I might add that I place an undue burden on the FAA and their inspection staff because it raises the level of security, and that means people work overtime.

Even though there have been no indications that there were any real compromises of safety at any of these airlines as a result of this situation, we recognize that it is also a risk, and so we have these enhanced inspection programs. The longer a company stays in bankruptcy, and subject to intense inspection by the FAA, the more difficult the burden gets from a nationwide viewpoint.

So we have to examine from our experiences at Eastern as to whether "enough is enough" in that regard. But having said that, last year was one of the safest, as reported by the NTSB, in history.

The airlines do not appear, whether in liquidation, in receivership, or very viable compromising even in these very difficult times on safety.

Mr. HAMMERSCHMIDT. Thank you, Mr. Chairman.

Mr. OBERSTAR. The gentleman from Illinois, Mr. Savage.

Mr. SAVAGE. Mr. Secretary, first let me draw on others who have previously commended you for your ardent support of the PFC. We are very proud of you, of course, coming from Illinois.

In your statement, you stated that most airlines have not been able to bring their labor costs under control. Then you add one might question whether something is seriously out of balance in the airline labor market.

The question I have is that, if you consider labor costs of such a problem, then how do you account for the fact that those airlines who are in Chapter 11 now have some of the lowest labor costs in the industry and the strongest airlines have some of the highest labor costs in the industry?

Secretary SKINNER. That is a good question, and let me first of all congratulate you on your selection as Chairman of another subcommittee of the full committee. I look forward to working with you. I am proud of another Illinoisan.

Let me say that one of the problems that many of these airlines have is debt, and that through bankruptcies and other circumstances, the airlines have incurred a substantial amount of debt which requires interest payments and payments of principal. And when the economy is turned down and with the other things that occurred, they have not been able to meet their interest and principal payments.

If the United transaction had gone forward as it was proposed two years ago before the collapse of the market, I suggest United would be in a similar situation to where many of these airlines are.

Those that are surviving and doing well, as we define it, have one common thread: none of them has an excessive debt structure, as the others do. Whether it be Eastern, Continental, TWA, Pan Am; those four in particular were encumbered with more debt than they could meet. And Delta, American, and United do not have that debt structure, although there was a period of time when both American and United, and this committee will remember, almost went through a period of reorganization where $3- to $4-billion would have been taken out of those companies, and a debt structure would have been in place that they now would have a very difficult time serving.

I just mention the labor situation, Congressman Savage, to indicate that there are a lot of factors working here, and that the marketplace should determine what the going rate is, and when the marketplace isn't allowed to work, costs sometimes are incurred that eventually get passed on to the consumer.

Mr. **Savage**. My questions go a bit further and raise this question that you mention, debt structure as a factor in the financial problem of certain airlines, and labor costs, of course, is a part of the debt structure, right?

Secretary **Skinner**. Well——

Mr. **Savage**. I mean, a contributing part.

Secretary **Skinner**. The labor costs generally fit into the category of operating costs. So they are passed through. When we say that no airline in the United States in the month of December, major airline, met its operating costs, that includes the cost of leases or purchase of the airplanes; and includes operating costs for labor, operating costs for fuel, gates and things like that. The debt cost, the interest and service on debt comes after operating costs and operating profit or loss. Labor comes before. There may be some debt that is required to be recapitalized because of some long-term pension requirements or health benefits. But generally it falls in the operating category rather than the capital area.

Mr. **Savage**. Let me express my final concern, and that is the delay in dealing with the CRS problem. It seems that with respect to the matter of foreign investment, that this policy statement appeared rather abrupt in the sense that the public only had a few days in which to comment prior to the issuance of the policy statement. Yet, your department's study back in 1988 indicated how anticompetitive, while the effect of the control of the CRS sometimes by United and American, and when the rules expired last month, we still had not come up with a proposed rule or change to meet this problem.

In your statement you indicate that such a rule proposal would come soon. Why is it taking so much longer to deal with that problem which is at the competitiveness effect when it seems you are able to move rather quickly regarding the foreign investments being raised to 49 percent?

Secretary **Skinner**. That is a very good question, and I must say I am not satisfied with the progress we have made on the CRS rule ourselves. I would only say it is very difficult—there are two issues that I face that I have the most difficulty with in reaching a fair and correct conclusion. One is what to do with CRS, and the other is what to do about slots.

I suppose in the traditional Washingtonian style, I have been a little guilty of kicking the can down the road in those two areas, because I don't want to make a mistake. I want to make sure when I go forward, I make the right decision—and I still am not comfortable that I know enough and have a feel for it, and that means we have had a delay, and I probably should try to reach closure, and we will try to do that sometime this quarter.

Mr. OBERSTAR. The gentleman from New York, Mr. Boehlert.

Mr. BOEHLERT. Mr. Chairman, on page 6 of your testimony you refer to the unhealthy environment for the consumer. I would like to talk about one aspect of what I consider to be an unhealthy environment.

What happened to the ticket holders on Eastern Airlines when Eastern ceased operations?

Secretary SKINNER. It is my understanding a fund had been established which would allow them to get refunds. Some airlines honored Eastern tickets and some did not, but the people holding Eastern tickets will get a refund from a court-established fund.

Mr. BOEHLERT. Has the bankruptcy court approved any such plan for Pan American or for Continental?

Secretary SKINNER. I don't know the answer for that question, but we will get it for you.

Mr. BOEHLERT. I think the answer is no, Mr. Secretary, which draws me to the area of my particular concern.

Since deregulation, we have had 160, 165 airlines go bellyup. As a result of that, many, many, consumers in America, have had a ticket which they had every right to expect would be worth something, only to find that it was worth nothing. Their only recourse, to stand in line in bankruptcy court. The consumer has been left high and dry.

So with that understanding, Mr. Secretary, I am just as concerned as you are about the unhealthy environment for the consumers. One of the things I have advocated and in the 101st Congress we passed it, but it got lost in the shuffle in the fight over random drug test, was a default protection plan. I must admit I have been greeted with less than an enthusiastic response from the Department of Transportation.

Are you rethinking the Department's position on some form of consumer protection plan so that the ticket-holders will have some degree of assurance that their ticket is actually worth something?

Secretary SKINNER. I am reminded that when Pan Am announced their transaction with United for the purpose of keeping themselves alive, one of the things they talked about establishing and made recommendations to the bankruptcy court about was the establishment of a hundred-million-dollar fund for these type of contingencies. I don't know what has happened, but of course that transaction has been completed.

The problem is that when these airlines face reality, they usually face it at the last minute with about $20- to $25- to $30-million in the bank in cash, and they don't anticipate it soon enough before the cash flow stops, and so therefore, there is no real cash to pay ticket holders.

We think there is an increasing awareness on behalf of a number of the airlines to deal with that problem up front. We are hopeful that the industry will deal with it so we don't have to deal with it in legislation.

I would also suggest that while I am not so sure what the exact numbers are on airline defaults, in a deregulated environment we are going to have some winners and losers just as we do in the gas station business.

Mr. BOEHLERT. I understand that, Mr. Secretary, but one person I don't want to see lose is the innocent consumer. Unfortunately they have taken it on the chin in the last decade. Literally thousands of dollars have been lost by families because they have had tickets for airlines that for one reason or another, have ceased operations, and they come to the court and say, What do we do now, and the answer is, You're out of luck.

I don't want consumers to be out of luck, Mr. Secretary. You know and I know that the domestic airline industry is in a precarious situation right now and almost comatose in some respects. And it is a tribute to American ingenuity that they are surviving.

I wish we had someone to explain to us why the American industry has to take it on the chin with respect to these excessive charges for fuel. I would like to see some degree of enthusiasm from the administration and the Department on legislation that would establish a default protection plan.

As you know, Mr. Secretary, my proposal lets the industry address the problem, gives them six months. You come up with a plan that is going to guarantee a measure of protection for the consumer and if you don't, we have got a guy in DOT named Skinner, that will come up with something. Will you address that?

Secretary SKINNER. It did get, I think, lost sometime ago, but we will revisit it.

I think, number one, we have had fewer bankruptcies recently than in the past, and the credit card companies are also now offering protection, but we will examine the whole thing.

Mr. BOEHLERT. Thank you. I really appreciate it.

One further question, Mr. Chairman.

I didn't hear your answer to Mr. Savage's question about the CRS system. When are you coming up with your recommendations?

Secretary SKINNER. We are in the process within the next several weeks of resolving it. We have been actively working on it, and we are hoping to get it done by the end of the first quarter.

Mr. BOEHLERT. Thank you very much.

Mr. OBERSTAR. That is a most important decision, and one that the committee will follow very, very closely.

The gentleman from California, Mr. Mineta.

Mr. MINETA. Thank you very much, Mr. Chairman.

Mr. Secretary, it is always good to have you before the committee. I apologize for having left and not hearing some of the other questions. But I would like to go back over, again, your recent decision as it relates to foreign investment.

It seems to me your original decision was a very good decision. You were able to strike a balance between control and equity holding, and I thought originally, you made the right decision as related to the Northwest-KLM situation. I am wondering if you could explain why this change between that time and now?

Secretary **Skinner**. The transaction presented to us by KLM and Northwest was the first of its kind, and of course it was part of a recapitalization and a whole new ownership structure of that airline.

From the very beginning, the owners of that airline, U.S. citizens all, and the owners of a vast majority of the voting stock, believed and claimed and took the position that the equity ownership, non-voting equity contribution, were not indicia of control, that they were in fact in control, that they would be selecting a vast majority of the directors, and that it was not an issue.

Out of an abundance of caution and because of the uncertainty and because of traditional rules that the Department had followed, we opted to disagree with them. A year and a half later, we had the opportunity to revisit the issue, because we had had monthly reporting requirements, all the decisions that had been before the Department. We were able to satisfy ourselves that Mr. Checchi and Mr. Wilson and Mr. Malek were in fact running the company, making the decisions, choosing the officers, and were in fact in control of that company. So the weight we had placed on the foreign investment, non-voting equity, and the influence we thought that investment might have, turned out not to be correct. So we were comfortable revisiting that after a year and a half of experience with a new owner.

Mr. **Mineta**. So are you now going to be comfortable revisiting Discovery Airlines?

Secretary **Skinner**. That, as you know, is a completely different situation.

Mr. **Mineta**. Why is that completely different?

Secretary **Skinner**. Discovery Airlines, as you know, made certain representations to the Department as to who the U.S. owner was. Many people on our staff raised questions about that, and we therefore said we had a decision to make. Because they made formal, sworn representations to the Department concerning U.S. citizenship, we had to determine whether to take those representations at face value and allow them to offer new competition in that market while we conducted a full investigation, or to assume automatically that they were lying to us and not do anything and not allow that competition?

My people that told me, "Conduct a full hearing and you will see that we are right," were right. The airline made misrepresentations, and thus it withdrew and stopped operations. I just wasn't ready to assume that every time somebody files an affidavit with the Department of Transportation representing that they are U.S. owned and non-foreign controlled, that that is incorrect and false. And I was proved wrong.

Had I known that they had been as callous and as disregardful of the law as that, it never would have happened. But I don't think we should be so distrustful to assume that every time a U.S. citizen says and represents that they are the owner, that they are not, and stop competition from beginning, I guess I was a little—they tried to blow one by me. They didn't blow it by us. We stopped operations. They took a big loss, and it was, as you know, restructured.

But I would rather opt for new competition and assume they are not lying to me than assume they are lying to me automatically.

You know, that is why we held the hearing. And it was a very short period of time.

Mr. **Mineta**. But it seems to me that when you say 49 percent is okay, and that that doesn't really mean control, I am wondering if that is really reality. If Saddam Hussein owned 49 percent of United Air Lines, and if you as Secretary of Transportation in the second or third week of January called up stage 2 under CRAF and you said to airlines, I need 180 aircraft, do you think United Air Lines would come up and say, Sure, Mr. Secretary, here are our airplanes for Desert Storm? I don't think that is reality.

So I don't understand what it was that really made the difference between your original decision and your recent decision as related to foreign ownership.

Secretary **Skinner**. Let's just take Northwest Airlines. Let's assume that Saddam Hussein was a 49 percent investor in Northwest Airlines. I believe that Mr. Checchi, Mr. Malek and Mr. Wilson would have turned over those airlines to CRAF, the Civil Rescue Air Fleet, as required by law, and that Mr. Saddam Hussein would have suffered a huge financial loss. That would have been all right with me, too.

So I think the question is, who is running the airline and what influence does the 49 percent investor have over them.

Mr. **Mineta**. Who drove you, though? Was the softness of the airline industry in terms of whether or not they are going to be able to survive?

Secretary **Skinner**. No. That caused us to accelerate the decision. The decision was made based upon whether or not Mr. Checchi, Mr. Malek, and Mr. Wilson were in control of that airline. And after a year and a half of experience, there is no question that they are in control, they are exercising their authority, and they are all U.S. citizens.

In the case, going back to the opposite, of Philip Ho, there were some questions raised as to whether he was actually controlled by his investors even though he was a U.S. citizen. It would appear that he was.

Mr. **Mineta**. Especially when I see this whole effort towards open sky, I wonder—is this a back door for cabotage to enter the picture and so that gets blown away. I just see this as the opening wedge, the proverbial camel's nose under the tent kind of thing, that just really opens itself up to enormous problems in the future.

If we go to open skies, how does a U.S. airline basically compete in a situation where they have, let's say, paying pilots $110,000, against an airline, X, Y, Z; on the other hand, in foreign country, that pays their pilots $58,000 or their flight attendants $5,000 a year and our flight attendants are making $40,000. Without bilateral agreements and going to open skies on the other hand, all this to me adds to a disastrous future for the airline industry.

Pan Am says in their application, We ought to be able to be treated the same as any other industry. They talk about telecommunications and airlines. I don't think we ought to be treating them the same because I think there is a national security element to whether or not someone, a foreign country, owns NBC or American Air Lines or American President Lines or Citibank. I think there is a difference, and it ought to be treated differently from a potato chip manufacturer. Sometimes I think this administration doesn't know the difference between a semiconductor chip and a potato chip when it comes to national security.

Secretary **SKINNER**. Well, we aren't suggesting that the airlines be treated like potato chip companies. That is why the law is as it is, and that is how it is going to be interpreted, and if the law is going to be changed on cabotage, it is going to be changed by this committee and its counterpart in the Senate.

Mr. **MINETA**. Are you going to try to do this under the tenet of the free trade issue?

Secretary **SKINNER**. I think we all recognize in the Canadian situation, if in fact we arrive—someday it may be the ultimate market. If we did that, we would in fact come before the committee to discuss the issues. We are not going to try to circumvent Congress.

Mr. **MINETA**. Secretary Dole stopped that when KLM tried to do that with an airline in Florida on the basis of the codes, and she saw that coming at the time after having made some initial agreement on it, and then she saw that she had to reverse herself on it.

Again, it just seems to me that, again, this is another—I mean, the camel's nose under the tent approach, and that it really just means further weakening of our airline industry and not backing them as we should be doing.

Secretary **SKINNER**. I think we are backing them, although you will get some disagreement maybe as early as this afternoon. I think we have got to do everything we can to strengthen them and give them access to the foreign markets, and the international market that is so strong and growing. That is the real growing market. And we must give them access to foreign capital there.

We are not suggesting this is a departure from U.S. law. In fact, if it is the nose under the tent, and the whole camel is trying to get under the tent, it is going to have to come before the committee.

Mr. **MINETA**. Mr. Secretary, I admire you very much, I just hope you get also on the CRS issue and on slot controlled airports, on a timely basis, and I think you ought to—you have got to also look at this whole issue as it relates not only to foreign ownership but in terms of where we go with the bilaterals.

I just feel somewhere that we are getting stiffed. You know, I can understand where we have access to markets, there ought to be open skies. But that is not reality. And we are getting stiffed in the meantime where people are allowed to play in our economic sandlot and we can't play in theirs.

Frankly, I just hope that as you and Secretary Shane and others that as you pursue this policy, that you are tough.

Secretary **SKINNER**. We were tough in the Japanese negotiations.

Mr. **MINETA**. The thing that bothered me is that we extended that to the 2nd of March.

Secretary **SKINNER**. They all stop flying on the 2nd of March if that is not resolved. We are entitled to what we have negotiated for and if we don't get it, we will go back to ground zero.

Regarding the negotiations with the United Kingdom, we are not getting fair treatment in the United Kingdom today. We are not going to pay an excessive price for something that we are entitled to and in any other country in the world we would be entitled to. We are entitled to a level playing field and free, open competition.

Mr. **Mineta**. Let me then ask, if the airlines are in better financial shape, and the Iraqi war ends or the recession is resolved, does this mean that you will back away from this ruling as it relates to foreign ownership? Are these dependent on just temporary things as we see them today? Are we going to be living with these things for some time to come?

Secretary **Skinner**. I think we are going to be living with foreign capital in the airline industry and synergies between investors from various countries, especially countries that have a fair and open market.

If the investors were seeking to invest in an airline in a regulated, closed market, I don't think you would see the reception that KLM got, which has a broad and open market.

Mr. **Mineta**. Thank you, Mr. Skinner.

Mr. **Oberstar**. I just want to read the Secretary's statement, September, 1989.

> It is clear from our precedent that a large share in our—equity poses—even where interest does not take the form of voter's stock, particularly if there are other ties to the foreign entity.
>
> January, 1991. While the facts of each case would have to be reviewed in their entirety, as a general matter, we would not construe foreign equity investment up to these limits taken alone as indicative of foreign control.

Do you base that judgment only on what you observed in the behavior within Northwest Airlines, and with respect to KLM's 57 percent equity control? You are dealing with some very strong individuals there who are pretty tough marketeers, managers of money. And you also had hanging over their heads the need to shift those dollar investments to another status.

Absent those strong personalities, absent those strong managerial people, absent a secretarial order hanging over the deal there might well have been a different outcome, and when you made the announcement, when the Department made that announcement in January, as a general rule, I thought it very troubling.

I am somewhat reassured that you have moved away from that, that in this case you are going to reconsider general rules. But that is 180 degrees, and it deserved more than three days, Mr. Secretary, in all respect.

Secretary **Skinner**. It was something that was being considered informally on a regular basis, and there will be another opportunity, if another situation presents itself, for anybody to comment. Hopefully we won't be under a situation of national crisis that will warrant some expedited proceedings.

The Philip Ho situation is a perfect example of where this Department, where it was represented that a 100-percent owner was a U.S. citizen, took the exact opposite tack, where we pulled their license to operate or they volunteered it before we had an opportunity to pull it. That is why every case has to be looked at on an individual basis.

Mr. **Oberstar**. Recognizing the serious problems the industry has, recognizing the Northwest problems, but before promulgating a general rule, we need more consideration.

The gentleman from North Carolina.

Mr. **Ballenger**. Thank you, Mr. Chairman.

I will ask fairly short questions, recognizing the light will probably work against me.

You mentioned jet fuel and that the price went skyrocketing, and then supposedly it is going to come back down as gasoline has done. But I also heard on the news about Desert Storm that if we could have picked an ideal place to have the air strikes, we couldn't have picked a better place than Saudi Arabia, which evidently has been a great exporter of jet fuel. But because of the air sorties that we are flying there, they are now having to import jet fuel into Saudi Arabia.

In your Department, has there been any opportunity to study or look at the possibility that the price of jet fuel, instead of falling, might go up because of the shortage created by Desert Storm?

Secretary SKINNER. Yes, even when usage exceeds 10 million gallons a day, when the allied forces are flying, it does not put an abnormal drain on the system. The availability of crude is what has caused the market to drop. And then, of course, some of the airlines have dropped flights during that period and we are now moving to a period throughout the winter for lower demand overall for crude. So I think we will be in good shape.

What happened is people panicked. The market went up as people began to replenish and refill their reservoirs. We worked on a daily basis with the Department of Defense and the Department of Energy to assess the situation. Secretary Watkins and I recommended very strongly to the President that he make the strategic petroleum reserve available. He has done so in conjunction with the nations throughout the world and that had a very salutary effect on the price and availability of jet fuel and or the perception that exists in the market.

So absent an extraordinary circumstance, which is not foreseeable, we believe that the jet fuel pricing problem is under control.

Mr. BALLENGER. Thank you, sir.

One other question that I would like to bring up, recognizing that you have made a judgment on Lufthansa in Charlotte, is it a matter of fairness that is hanging up the negotiations?

Secretary SKINNER. Yes, and that gives me an opportunity to go to a point that Congressman Mineta and others have made, and that is that we offered under our "Cities" program the opportunity to serve U.S. cities that are unserved, and giving the opportunity first to U.S. flag carriers. Lufthansa was the first under our U.S. cities program. The condition is that they would open their market and we would get into a pro-competitive pricing system and we would see progress in the FRG, and now the Republic of Germany market, where they had a right to object to our prices on a double-approval basis. They haven't made progress, although we are in the process of getting results from a new transportation minister. So we continued that for a period of time to see if there is going to be any progress.

As you can see, a number of Members of this committee feel if we are going to open opportunities, we have got to have opportunities on both sides of the ocean, and we have got to have a free marketplace in a pro-competitive marketplace. That is what we have asked the Germans to do, and I am still optimistic that they will.

However, the Desert Storm situation has obviously changed some of the dynamics. Some of the volume and demand are off, and Lufthansa will have to make a decision to ride out Desert Storm if in fact they are going to be in a market. So that decision will be made by the marketplace and by the German government after consultation with their national carrier, Lufthansa.

Mr. **Ballenger**. One more quick comment, if I may. I fly out of Charlotte twice a week, and when you go into the airport you see one Pan Am plane and one Trans World plane, TWA, and 40 U.S. Air planes. You realize that the two competitors at those gates there are very weak. I don't know what those gates are worth, but surely you can find somebody besides U.S. Air to sell those gates to. It is almost a noncompetitive market we have in Charlotte.

Secretary **Skinner**. What it takes to compete in any of these markets is access to enough gates and enough facilities in the airport, in this case Charlotte, so you can run competitive route structures—route structures that have the amount of frequencies that your competitor does. That requires a carrier to come into Charlotte to compete against U.S. Air and to put enough equipment and enough people in there to really offer competitive service.

And that is the problem we now have in Atlanta, which is even a bigger market than Charlotte. Nobody wants to go in and really go toe-to-toe with Delta. That means that Delta is probably going to be the beneficiary of the Eastern situation.

We are doing everything we can to encourage another carrier to go in there, and the Antitrust Division is looking at the gate situation and the transfer as it relates to Atlanta, and I am sure they will be looking at Charlotte as well.

Mr. **Oberstar**. The gentleman from the Virgin Islands, Mr. de Lugo.

Mr. **de Lugo**. Thank you very much, Mr. Chairman.

Let me apologize to Secretary Skinner for not being here to listen to your testimony. I have been going over your prepared testimony and I couldn't be here because we were organizing another committee on which I serve. I will be very brief because a lot of other Members, I know, have questions for you.

My good friend Gus asked one of the questions that I planned to ask you. I see that you were saying that the problems with the airline industry should not be read as an indictment on deregulation. And then you go on to cite studies and figures.

Now, in my area, which is an offshore area, the Virgin Islands, we are totally dependent on airline service. There are cruise boats that come, but you don't travel on a cruise boat to stay any length of time in the territory. We have got real problems because Eastern Airlines has just gone under and that was, I would say, the biggest—they had the most service in there.

We also have one airline that is in very good shape, that is American Air Lines. But then we have got a number of others. We have got Continental that is in Chapter 11, and we have other airlines that are very shaky, according to industry reports that have come to our attention, such as Midway.

Now, how would you respond to me if I say that I have got real questions about this whole deregulation approach, as far as my constituency goes?

Secretary **Skinner**. First of all, I haven't looked at that area, but I will ask our economists to do so. I think you will see that the citizens of the Virgin Islands, and the entire Caribbean area have in fact benefited from deregulation and low fares, as adjusted on a real cash basis. Nationally there is more service to cities of all sizes than ever before, and the frequency is greater, and at a lower cost. That is the general situation. We will provide specific numbers on your area.

Number two, as for the future of the airline industry, competition, which is essential in a deregulated environment, depends upon airlines having capital to expand their networks, to buy the equipment they have on order, so they can put airplanes in competition against the carriers that currently serve the market.

One of the ways they can do that, if there is no capital in the domestic market, is to search for investments from abroad. That is the policy we announced last week, encouraging foreign investment to raise capital, to buy the airplanes, to expand the services, to serve the market.

Mr. **de Lugo**. I thank you, Mr. Secretary.

I have a more pointed question I will prepare and deliver to you. I would appreciate it if you would respond to that for the record.

Secretary **Skinner**. Thank you very much.

Mr. **de Lugo**. I thank the Chairman.

[Secretary Skinner's reply to Mr. de Lugo's question regarding air service to the Virgin Islands follows:]

Service to the Virgin Islands has greatly improved under deregulation. Only two major carriers—American and Eastern—provided service prior to deregulation; today, even after Eastern's cessation of operations, four large carriers—American, Continental, Pan American, and Midway—provide service to most major American cities through eight hub airports. Moreover, airline fares to and from the Virgin Islands have decreased significantly during the 1980's. Real average fares between Harry S. Truman Airport and the top 20 mainland markets (which account for 90 percent of the mainland-Virgin Island traffic) declined by 24 percent between 1984 and 1990. In certain markets the decrease was even more substantial: For Washington Dulles, real fares decreased by 48 percent; for Baltimore-Washington International, real fares decreased by 39 percent, for Washington National, fares decreased by 31 percent and for Los Angeles, fares decreased by 31 percent.

While you are correct to point out that only one of the four airlines serving the Virgin Islands is financially healthy at the current time, your fear that eventually only one airline might provide service to the Virgin Islands is not borne out by past experience under deregulation in this country. Our experience has been that when a carrier fails or is acquired by another carrier, competition intensifies as surviving carriers attempt to fill the void. Should one or more of the carriers serving the Virgin Islands cease operations altogether, it is likely that some other financially strong carrier would begin to serve the Virgin Islands, either directly or through San Juan, Puerto Rico. United, Delta, USAir, and Trans World Airlines currently provide service to San Juan from various mainland points and might well extend their service to the Virgin Islands. Given the large and increasing demand for air travel to the Virgin Islands, the least likely outcome of consolidation would be to leave the Virgin Islands with a single carrier providing service to the mainland.

Mr. **Oberstar**. The gentleman from Tennessee, Mr. Duncan.

Mr. **Duncan**. Mr. Secretary, we seem to speak of deregulation on this committee like there has been total deregulation, like there is no regulation at all.

Yet some in the airline industry say their industry remains one of the most highly regulated industries in the country. I would like to know which is the case.

We seem to indicate on this committee there is some kind of laissez faire condition out there. Yet it appears to me this remains a highly regulated industry in spite of the deregulations that have been made over the last few years.

I would like your feelings on that.

Secretary SKINNER. Let me see if I can lay it out.

First of all, we don't regulate prices in the domestic market whatsoever.

As was indicated by the price wars that occurred over the last several months, airlines have been pricing their product and following each other. Because airline travel is a very fungible product, a $10 adjustment in price between one airline and the other, as loyal as they might be to one carrier, a lot of people in the domestic market will, in fact, opt for the lowest priced carrier.

We really have a deregulated environment in the domestic market.

In the international market, we have a little different situation. It varies country by country. We have negotiated over 70 bilateral aviation agreements throughout the world. Some of the markets in countries we negotiate with have a very deregulated, free, competitive market, like the Netherlands and others.

Others have a very regulated market. We talked about one moments ago, the German market. There the pricing is subject to a lot more regulation and a lot more approvals by government.

We are pushing to get that deregulated as well.

In the United States as well as the world, we regulate airlines on the issue of safety and will continue to do so, and in the area of security and also will continue to do so.

There is no regulation in the allocation of gates or capacity within the system, with the exception of the four slot controlled airports in the United States, LaGuardia, JFK, Washington National, and O'Hare. There we allocate slots on an initial basis and then generally the free market place determines what the price of those slots or access to that market will be.

So when you put all of that together, we have deregulated pricing and regulated safety in the domestic market, and the international market. In the international market, there is a deregulated and in some cases regulated pricing scheme.

Mr. DUNCAN. Do you feel there is ease of entry into the industry now?

Let's say if a group of businessmen or women wanted to put together a small airline, do you feel like there is sufficient ease of entry into the industry that new businesses could develop, and is your department doing anything to encourage that or assist that if some people came to you and requested assistance?

Secretary SKINNER. Entry is difficult because of the capital required. The airline industry is very capital-intensive. This afternoon, you will hear from Mr. Beauvais, one of the most successful, if not the most successful, new entrants in the marketplace in a company he built.

It is a tremendous credit to him and his employees. I would guess he will say it is very difficult to enter.

It is very difficult to develop a competitive route structure.

You have to carve out a niche and be different than the majors in order to make that a success. There have been situations where that has occurred.

We have given out a couple of operating certificates out in the last couple of years. Our Department has helped in any way we can. The key is that there is no capital available or very limited capital available. That becomes a crucial issue in a growing airline or getting established.

America West, as well as Southwest, its competitor now in Phoenix, along with a company called Alaska Air in another part of the country are success stories of new entrants. There ares some, but it is difficult, because the industry is so capital intensive.

Nobody wants to invest in the airline industry today because no one is making any money.

Mr. Duncan. If we had the re-regulation of fares and other things that some are calling for, what, in your opinion, would be the result of that?

Would we continue to see a decrease in the number of airlines?

What would be the effect on the prices and fares and so forth?

Secretary Skinner. Prices would go up significantly. There would be no control on the costs and no pressure to control costs as there is under deregulation.

You would be passing through, as we do in utilities and gas companies all over this country, the cost of doing business plus some. We have seen what has happened in another industry, the telephone industry, when they went to deregulation. While some would claim we should have kept it as it was, I think a number of others would say we have real price competition between MCI, Sprint and AT&T and there are a lot of different opportunities to compete for telecommunications services that you never had before.

That was a regulated industry like the airline industry where costs were being passed through. The real problem in a regulated industry is there is no real incentive to control costs.

You can go before the rate-setting agency and commission and they will pass through the costs to the consumer. That is really the problem that the airline industry faced and no longer faces.

Prices would, cost structures would go up, and there would be a lot less competition. You would go back to a lethargic, antiquated, archaic system that other countries all over the world are moving forward to eliminate.

How can we stay competitive as a world economy if we do not move in the direction they are moving, which is pro-competition, low cost.

Mr. Duncan. All right. My red light is on.

Thank you, Mr. Chairman.

Mr. Oberstar. The gentleman from Pennsylvania, Mr. Kolter.

Mr. Kolter. Thank you, Mr. Chairman.

Secretary Skinner, I want to say that this committee, whether we agree or disagree with you, always finds that you stimulate our thinking. I say that, sir, because I respectfully disagree with your premise on page six of your testimony that the Railway Labor Act is outdated.

That brings up my question.

I yield to you, Mr. Chairman.

Mr. SAVAGE. I thank the gentleman from Pennsylvania for yielding.

Mr. Secretary, related to the line of questioning which I know he is about to embark upon, on page 6 of your testimony, still on the labor question, where you refer to the need for a strictly free market, that is the second paragraph on page 6, "These wages are not the product of a strictly free market."

And then the last sentence in that same paragraph where you repeat what I asked before about my question about whether something is seriously out of balance in the airline labor market, what I am trying to determine, I am trying to determine whether this reference to things being out of balance in the labor market in the airline industry, are you there—was that a pro-collective bargaining statement or is that critical of the collective bargaining in the airline industry?

Secretary SKINNER. It is the question whether management and labor have addressed the issue of costs. It is just a question of whether the marketplace is determining costs.

If the marketplace doesn't determine costs and they exceed what the marketplace would produce, the consumer pays. That is an issue. I think if you talked to most major airline executives, they will tell you the biggest challenge they face is to stay competitive in the cost area.

I only raised the question. It is not pro-labor, pro-management. I think, you know, if you don't have a competitively priced product, somebody has got to pay and usually it is the consumer.

Mr. SAVAGE. What I am getting at is do you feel that collective bargaining produces such a competitive market or it does not?

Secretary SKINNER. I am sorry. Well, it can.

It can and does in many industries. In this one, because of some of the things that go on, some have raised the question whether it does and whether we have competitive bargaining. I am a great believer in the labor process and the way labor and management work together.

I am not unmindful of the results that the American worker has received as a result of that. It is like any system. It has to stay in balance.

Sometimes systems get out of balance.

Mr. SAVAGE. Are you suggesting that collective bargaining as it presently exists in the airline industry has not resulted in a proper balance?

Are you suggesting there is another factor that should be thrown in?

Secretary SKINNER. I think the collective bargaining process is not working to develop a market-driven price.

Mr. SAVAGE. Thank you, Mr. Secretary.

Thank you.

Mr. KOLTER. You are welcome, Mr. Chairman.

Mr. Secretary, back to my question.

Do you feel removing the airline industry from the Railway Labor Act would reduce the number of strikes we have in the industry?

I am sure you are going to say yes. How do you come to these conclusions?

Secretary SKINNER. I am not so sure that in and of itself is going to reduce the number of strikes. Because there are two factors. The main factor, as you know, is that there is only one industry left where secondary picketing is not illegal, and that is the transportation industry.

That provides leverage to organized labor which they use on occasion—in the rail industry, in particular—which means that we really have no strikes in the railroad industry of any significance, that we have gotten to a position where the Congress of the United States, in the last big impasse we had took the Presidential Emergency Board's recommendations, analyzed them, adopted them into law. So there was no strike because of that process, because the strike would be so destructive to the economy of this country that the Congress decided not to allow it.

That power is also available in the airline industry, although it hasn't been used recently.

I just think we have got to have a balanced system so that people have a fair chance to negotiate for wages and benefits and the consumer has a fair chance to make sure that wages and benefits that go into the cost of their product are fair and market-driven, not excessive, because the consumer then pays an excessive amount.

It is beyond the market, and it makes us less competitive in the world market.

Mr. KOLTER. So the record indicates then that really the Railway Labor Act has very little to do with strikes in the airline industry?

Secretary SKINNER. It makes a strike very difficult, if not impossible. In a strike the ability to strike is a valued asset of organized labor. It is probably their most important tool in the collective bargaining system.

And the employer has to be aware of it, but the employer also understands the collective bargaining system and has to weigh the pluses and minuses of a strike.

Most employers don't weigh that anymore, because they can't afford to take a strike. Therefore, they negotiate without that in their analysis. All I say is that if you can go to the marketplace and hire a fully qualified mechanic for a given amount of money and several airlines are paying twice that because they haven't been able to get to the marketplace, that creates a non-market-driven wage and the consumer pays for that.

Mr. OBERSTAR. The gentleman's time has expired.

The gentlewoman from New York, Ms. Molinari.

Ms. MOLINARI. Secretary Skinner, we have just spent about two-and-a-half hours discussing some of the problems in the industry and solutions toward the future. Yet it seems to me despite all the creative solutions that have been advanced today by both yourself and my colleagues, a front page like this one repeated throughout the nation does much more to affect our industry than just about anything else that we have discussed.

My concern comes in at a time when we are still having support problems at airports, albeit notwithstanding your claim that 1990 was the safest year to fly.

What is the department doing and, therefore, FAA doing to make sure as we increase capacity through PFCs and encourage international negotiations that we, in fact, have the structure in place? Maintenance facilities, air traffic controllers, proper procedures and machinery and equipment in place to handle this increased capacity so that we no longer have to live in fear of headlines like this?

Secretary **Skinner**. Well, Congresswoman Molinari, first of all, the report that you talked about stating that 1990 was the safest year ever was a report of the National Transportation Safety Board, with which I have no real relationship other than receiving their comments, recommendations and communications.

I have a good working relationship with them. They are the ones that said it was the safest year ever.

Let me tell you, however, you have raised a question that is a family tradition, I might add, which I respect— —

Ms. **Molinari**. I thought it might have sounded a little familiar to you, Mr. Secretary.

Secretary **Skinner**. The budget request for the Federal Aviation Administration this year has gone up from 1991 enacted level of $8.1 billion to a 1992 requested level of $9.2 billion.

That is a 14 percent increase. For operations, it is a ten percent increase; for Facilities & Equipment, it is a 29 percent increase; for the Airport Improvement Programs increases six percent; for research, an additional two percent.

The total request, as I said, is 14 percent higher, a $1.1 billion increase on an $8 billion base.

We continue to grow the system at a very substantial rate. A good portion of that is the result of the work of this committee and others in getting the reauthorization process through.

We are asking for an increase in our controller forces to 17,945, an issue I know you are familiar with. A 2.3 increase in the other part of the FAA work force, a 74 percent increase in the area of safety and support areas directly related to safety, the inspectors, aviation security personnel, and field maintenance.

We are trying to stay current. The airline industry is, as you know, susceptible to headlines like that because, even though we lose 45,000 lives on the highway every year and lose only several hundred—although each is very—tragic in the aviation industry, that is the headline we have to deal with.

We are doing everything we can to enhance the capacity and safety of the system, to add additional equipment, to bring the equipment to 1990 technology levels rather than 1950 technology levels, and get our work force up to full performance level.

We are making progress in that regard, but still have a ways to go.

New York, of course, is the hardest area of the country to recruit employees. We have to find new and creative ways to recruit people. One of the things we are looking at now is establishing training facilities in the recruiting areas, so we recruit from within the New York area so people will return to the New York area, for the remainder of their career.

These are all part of the process to assist in our most critical area of capacity, and that is New York. We are making progress, but not quite as much as we would like.

Ms. **Molinari**. Of course, Mr. Secretary, I know your response to my suggestion that perhaps some of the air traffic controllers that are still looking for work be rehired. I know what your answer would be for that.

May I follow up and ask that I get a copy of the paper you read from that gave us the breakdown of the budget.

[The following was received from Secretary Skinner:]

FEDERAL AVIATION ADMINISTRATION FY 1992 BUDGET SUMMARY

[Dollar amounts in billions]

	FY 1991 enacted	FY 1992 request	Percentage increase versus enacted
FAA total	$8.138	$9.267	14
Operations	4.037	4.457	+10
F&E	2.095	2.700	+29
AIP (Ob. lim.)	1.800	1.900	+6
Research	.205	.210	+2

Total request of $9.3 billion in combined appropriation and obligation limitations is about 14% ($1.1 billion) over the FY 1991 level of $8.1 billion. The major increase is in the FAA's Facilities and Equipment program to support the Capital Investment Plan, the central feature of which is modernization and updating of the national airspace system. (The +14 percent growth we are proposing, compares to a proposed 16 percent in FY 1991 and is equal to the 14 percent growth rate enacted last year by Congress.)

OPERATING EXPENSES

Request of $4.4 billion is a 10% ($420 million) increase above the FY 1991 level. The majority of the increase is to cover price level inflation, annualization, and other non-discretionary cost increases for FY 1992.

STAFFING

Minimum controller work force of 17,945 (+450 positions)

2.3% increase (+770 positions) in other FAA work force.

Over 570 (74%) of the additional positions provide continuing increases in safety, and support areas directly related to safety:

Aviation safety inspectors of 3,158 (+100) and safety inspector support of 1,180 (+36)

Aviation security personnel of 1,026 (+178)

Field maintenance technicians of 9,793 (+260)

The remaining 196 positions are primarily safety and drug-related support, such as 70 additional positions to support the requirements of the industry drug abatement program, and 69 additional positions in support of the Airmen and Aircraft Registry.

Mr. **Oberstar**. The gentleman from Illinois, Mr. Lipinski.

Mr. **Lipinski**. It is always a pleasure to see my fellow Illinoisan, Chicagoan, and the greatest Secretary of Transportation in the history of this republic.

Good morning, Mr. Skinner.

You mentioned earlier, quite a while earlier now, but you mentioned earlier, that you believed that the growth for the American airline industry is going to be international competition, is that correct?

Secretary **Skinner**. If the lastest trends of the last couple of years are correct, the growth will be much greater in the international market than in the domestic market although the domestic market after we come out of this downturn, will grow.

Mr. LIPINSKI. Do you have any idea what the percentage of profit the American airline industry makes off of their international flights rather than their domestic flights?

Secretary SKINNER. I don't have those exact numbers. I am sure Mr. Beauvais can give you those for America West.

Knowing how much they study each other, I am sure he can probably give you a feel. I think the more profitable lines' business right now are the international lines.

Mr. LIPINSKI. There are 31—I see him nodding over there. There are 31 foreign carriers that service the United States. They are represented by about 29 countries.

Do we have reciprocity with those 29 countries?

Secretary SKINNER. Well, I can't answer all of them. Most of the countries represented here, in fact all of them, operate bilateral agreements.

Some of them may serve our country without our serving their country, not because we don't have the right to but because no carrier has sought to.

In some countries, we have unserved markets where we have the right to serve the market, but no carrier finds it profitable. With regard to those countries the service comes one way to the U.S. because it involves national carriers, national-supported carriers who desire that access.

There are a few like that.

But generally we have genuine reciprocity through the bilateral process.

Mr. LIPINSKI. Out of the 31 foreign carriers that fly into the United States, 22 of them are at least majority owned by foreign governments. Do you see this as being unfair competition for our American carriers when they are totally privately financed and in competition against 22 airlines that are primarily if not entirely financed by their governments?

Secretary SKINNER. I look at it as an advantage to the U.S. in some cases because involvement of foreign government means involvement of bureaucracies in airlines and they do not generally do the job as well as private management. That is one of the reasons that British Airways was privatized.

I had the opportunity to visit Israel over the holidays. In that visit, in the Middle East, we talked to a number of people who have been involved in the movement of airlines from a nationalized basis to a privatized basis.

The biggest problem they have is that the work force is too big for the job that needs to be done. They have to downsize the work force. So government ownership can be a competitive disadvantage.

In answer to your first question, we have ten carriers in this country serving and competing with 31 foreign carriers. We have about 50 percent of the traffic in those markets.

So our ten carriers are competing on an equal basis with the 31 foreign carriers. In some cases—and I won't mention them because I don't want to insult others—but my observation is that some do a very good job.

Most of those are privately owned. The national-owned carriers are not as competitive in quality of service, attitude, and price as our privately owned U.S. carriers.

There is an exception here or there.

Mr. **Lipinski**. Do you know what foreign carriers do the most business here in the United States?

Secretary **Skinner**. In order of frequency?

We will get that for you.

[The information received from Secretary Skinner follows:]

The top 10 foreign air carriers, in terms of departures at U.S. cities, are as follows:

Weekly departures from large and medium hubs

Air Canada	568
Mexicana	272
British Airways	228
Canadian Airlines	134
Aeromexico	130
Lufthansa	112
Quantas	75
Air Jamaica	69
KLM	53
Bahamasair	53

As shown, the top three carriers—Air Canada, Mexicana, and British Airways—provide the most departures by a wide margin, and only six carriers, including two Canadian and two Mexican, provide as many as 100 departures a week from U.S. points.

Secretary **Skinner**. The most noted ones obviously are British Air, Air France, Lufthansa, JAL. They are major, along with some presence from SAS, KLM, Alitalia, Iberia, and we, even now I think, have an Aeroflot flight or two.

Mr. **Lipinski**. Not to disagree with you, but you just delineated a number of carriers that are owned by the governmental from which they come.

Secretary **Skinner**. That is why we are doing so well against them.

Mr. **Lipinski**. That is why we are—I could follow that one, but I will let it go.

Thank you, Mr. Chairman.

Secretary **Skinner**. Thank you for your kind and undeserved compliment.

Mr. **Oberstar**. The gentleman from Kansas.

Mr. **Nichols**. No questions, Mr. Chairman.

Thank you.

Mr. **Oberstar**. The gentleman from Georgia, Mr. Lewis.

Mr. **Lewis**. Thank you, Mr. Chairman.

Mr. Secretary, good to see you.

Like my colleagues, I want to thank you for your outstanding leadership.

Mr. Secretary, how could you be so optimistic about the future of the airline industry when Eastern has ceased to operate since your last visit before this committee? And with Continental and Pan Am in real trouble?

Are we moving toward the day of the "big three", Delta, American, and United?

Secretary SKINNER. I think we are moving toward the years of the "big more than three and less than seven," along with some very substantial carriers, you know, like America West.

There should be some other players that aren't going to be as big as American, Delta, United, U.S. Air, Northwest.

There will be a combination of carriers that I think will be more than three and less than seven that will be called giants.

Mr. LEWIS. Mr. Secretary, I have another question.

I am not so sure how I should phrase the question because of Eastern being out of business. More than 7,600 employees from the greater Atlanta area out of work. Let me just ask. When you take a long, hard look and look back, do you think that you and your Administration did all you could to keep Eastern in business?

For the most part, the city of Atlanta has become a city—a city of one airline.

Secretary SKINNER. Congressman, I feel as strongly as you do about that. I mentioned it several times during my testimony, the situation in Atlanta. We have to find ways to get a competitive carrier in there against Delta which now, of course, has made a bid on concourses A and B.

We have to get competition in that market or the people of Atlanta will do that. That is why we have to get capital into some of these carriers so they can buy equipment, expand their fleets and serve Atlanta like Delta is.

Number two, we cannot change some events. Eastern Airlines was in trouble for many years, long before Mr. Lorenzo and even Mr. Borman took over the management of that company. It is a tragedy.

It is a tragedy and everybody gave it a valiant effort. We cooperated in helping the airline raise cash. It just didn't have the network or price structure or a wage structure that would allow it to compete and survive, given the problems of the past or the future.

There is nothing, I think, that we could have done that would have changed the inevitable result. They gave it a valiant, good, good effort.

The attitude of the employees to the end was really outstanding. As I am sure you know, and as I learned in my travels on that airline, they were really giving an all-out effort.

It came too late. With Desert Storm and the fuel price problems, the downturn in the economy, it just wasn't to be.

It is as I said, a tragedy.

Mr. LEWIS. Mr. Secretary, it seems like we are bailing out everything else. Did we ever consider bailing out Eastern?

Secretary SKINNER. We did not consider bailing out Eastern. We are supporting the depositors of the Federal Deposit Insurance Corporation and the Federal Savings and Loan Insurance Corporation.

The Federal Government in the savings and loan industry assumed a responsibility to insure deposits up to $100,000 and depositors all over the country are being bailed out. The Government, putting money into the savings and loan industry to minimize the loss to the Federal Deposit Insurance Corporation or the Federal Savings and Loan Insurance Corporation.

We don't have that kind of insurance available in the airline industry. There has been no real talk of subsidy. That would be a return to regulation, which we are seeing progress away from all over the world.

Mr. LEWIS. I think in another period and another day, maybe not on your watch, we bailed out Lockheed, Crysler.

Secretary SKINNER. We have. Chrysler, again, finds itself in financial difficulty as do all the automobile manufacturers. Every situation is different, but there has been no effort nor any real serious consideration to bailing out the aviation industry.

What we have done is try to help them through a very difficult period of time by accelerating the governmental process, by finding new ways to assist them in attracting capital, to find new ways to allow them to restructure either through bankruptcy or out of bankruptcy so they can stay alive through this difficult time and raise cash.

We have done that for Eastern and for others.

Mr. LEWIS. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. OBERSTAR. The gentleman from Virginia, Mr. Payne.

Mr. PAYNE. Thank you, Mr. Chairman.

Thank you very much, Mr. Secretary, for being here and staying here so long with us today.

We appreciate it very much. We appreciate the good job you are doing.

You stated in your testimony that what is going on now is a fundamental long-term restructuring which has perhaps been accelerated but we will come out of this with a healthier industry as a result.

I think that that is good news for consumers and good news for the industry and good news for the American economy.

But the economy is how do we get from where we are today to that healthier industry? The losses that we talked about, the $2 billion, last year were staggering losses, but particularly staggering since in the first quarter, we experienced 85 percent of those, and $1.7 billion.

With the exception of the fuel prices which have eased, reasons for those losses are still with us, meaning that the 1991 period may be a very difficult period for the industry as well, which brings me to my questions.

Has the department looked at what likely those losses may be?

How much capital may have to be raised in order to cover those losses?

And due to the credit crunch of the—the domestic credit crunch you mentioned, what percentage of that money will have to be raised from foreign interest?

Secretary SKINNER. Well, we haven't looked at detailed numbers, although the Air Transport Association, the airline association, has. They predict—the current forecast predicts 1991 to be about a break-even year for the industry.

For 1992, the ATA forecasts a return to normal profits. That forecast is based on stable fuel prices and a return to normal traffic growth by the beginning of the summer travel season.

There is no question they are going to have to replenish their working capital. The airlines, frankly, have to learn to manage in an industry which is susceptible to ups and downs in the economy.

That is one of the first industries that feels that downturn in the economy.

They all went on expansion programs. Some of them went on major recapitalization programs. They took a lot of that working capital out of the industry and into debt. Those secured and unsecured creditors are now going to pay the price for those decisions and they are going to have to find ways to replenish their capital, to buy the airplanes currently on order to meet expansion needs.

They seem to be comfortable with their ability to do that in the long run. The majority of them have asked for access to more foreign capital because of the problems you just described. We are going to allow that consistent with Federal law and United States ownership and control of those airlines.

Mr. PAYNE. Just as a quick follow-up, what recommendations do you have for this subcommittee concerning any actions or inaction that should be taken as a result of the condition of the airline industry today?

Secretary SKINNER. Well, I think one of the things you will be considering as a result of Congressman Clinger's bill is to consider whether we can go further in areas which will allow the industry to attract capital and still meet the needs of national defense in the multinational world we are going to be involved in.

I encourage you to look at that bill, just as we will, to see if there is any potential in that legislation, or to come up with other similar legislation. The future of this airline industry is going to depend on its ability to attract capital, and this will depend on its ability to pay debt and to give a return on equity to investors and to control their costs, so they don't price themselves out of the market.

One of the things we haven't talked about is that this market is very sensitive to price differentials, not only between airlines but between alternative methods of travel. If you ask a family of four traveling to Florida for a week to pay $1,400 instead of paying $700, they will then get in the family automobile and drive to Florida. That, I might add, increases the risk of injury on the highways.

The market today is very susceptible to changes in pricing. They have to keep their prices under control if they are going to grow.

Mr. PAYNE. Thank you, Mr. Secretary.

Mr. OBERSTAR. The gentleman from Mississippi, Mr. Parker?

Mr. PARKER. Thank you, Mr. Chairman.

I want to correct something. You said the Federal Government assumed responsibility for $100,000. They have assumed responsibility for the whole thing. They don't let anybody lose any money, whether they have insurance on it or not.

I would like your responses to something. A horse is a funny animal. He is odd. We have an old saying back home, "You eat like a horse." A horse doesn't know when to quit eating. Every farmer out there knows if you put an unlimited amount of feed on that horse, he will eat himself to death. He founders. The thing about foundering, you have a bone in the hoof of a horse and it clicks when he is foundering.

Now, the reason I say that is that it seems to me we have some very large airlines that have targeted their smaller competition.

They know where they can target. They know where their weaknesses are. And they have forced them—when you talk about these low prices—they have put them in a position to where these smaller airlines have to sell below cost.

Every businessperson out there knows if you can get your competitor to sell below cost, you don't want to feed it to him with a teaspoon; you want to feed it to him with a scoop shovel. Over a period of time, you will destroy the smaller competitor. A lot of the larger airlines are utilizing this, in my opinion, utilizing deregulation, to play that game. The Department of Transportation, due to acquiescence or whatever, is allowing those larger airlines to do that, because you can't stay in business when you are selling below cost.

It is an odd, odd thing whenever I hear people walking up and down these halls out here. Sometimes I hear their heels clicking.

I would like to have your response as far as what the Department of Transportation views as using deregulation in a competitive manner that destroys competition instead of enhancing it.

Secretary **Skinner**. I think if the experiences of the last four months are correct, you would find that the big megagiants would tell you—as they have told me—that their prices were driven down by the competitors like Eastern that were pricing their product at a much lower rate than costs. Because of the fungibility of the product and the sensitivity to pricing, they were forced into pricing down.

One of the reasons they have lost so much equity on the East Coast is because Eastern was pricing its product to regain market share, and Eastern's secured and unsecured creditors subsidized the airline and permitted to charge a very low fare.

I am not so sure generally in the last few months that you would get industry agreement with what you are saying on both sides.

Mr. **Parker**. Are you saying it did occur earlier?

Secretary **Skinner**. No. What I am saying is Eastern set the price which everybody met, including the Deltas and the USAirs. They all lost money meeting that price. So it was the small carrier setting the price for the big carrier.

Number two, predatory pricing, which is what you are talking about, is always a possibility; but it is against the law and it is looked at very, very carefully by the Antitrust Division. And the America Wests, the Southwests, the Alaska Airlines could not exist today if there were predatory pricing because, as Mr. Bruce Kennedy from Alaska Air, which runs up and down the coast from Mexico to Alaska, will tell you if they wanted to, they could run routes against him, structures against him that would drive him out of business in days.

Mr. **Parker**. People can't be too obvious. You know that as well as I do. I am interested in talking to some of these smaller air carriers to see what their feelings are. I think we have a tremendous problem. When you start sitting around talking about having three, less than seven, more than three major airlines, I think there are national security implications for our nation.

I think that that is a problem.

Thank you, Mr. Chairman.

Secretary SKINNER. Good. I encourage you to have a conversation with them. I have had a lot over the last several weeks. I would only suggest if you have five major carriers all with resources, great resources, they are going to be able to compete against each other quite well on a basically level playing field.

The inequity becomes when the big one is competing with a bunch of little ones. When you have a lot of big carriers, you have a more level ability to compete with each other.

Mr. PARKER. That is what we have been headed towards? Getting the big ones in there?

Secretary SKINNER. I would suggest one of the best growing competitive companies in this country, the number one retailer in the world, is Wal-Mart; and Wal-Mart has taken the individual store owner we have known and it has moved forward to a point where it is the largest retailer in the world.

So that is the way industry is going, whether it be in aviation, retailing or anything else.

Mr. PARKER. With all due respect to Sam Walton, Wal-Mart does not have national security implications for this country.

Thank you, Mr. Chairman.

Secretary SKINNER. I would say just because you have five to seven carriers, if they are flying the same number of airplanes or more airplanes, and they are all U.S.-controlled, we still have the amount of facilities.

Mr. PARKER. Thank you. I have additional questions to submit to the Secretary for response for the record.

Mr. OBERSTAR. Without objection, so ordered.

[Questions submitted to Secretary Skinner by Mr. Parker and responses follow:]

QUESTIONS SUBMITTED TO SECRETARY SKINNER BY CONGRESSMAN MIKE PARKER OF MISSISSIPPI

Mr. PARKER. In the mid-1970's Congress and your Department faced a transportation crisis in the railroad industry not unlike the one facing the airline industry today. Six Northeastern and Midwestern railroads faced bankruptcy, leaving the real possibility of the elimination of freight rail service for significant portions of the nation. That crisis was met with creation of the U.S. Railway Association which provided an assortment of loans and loan guarantees to railroads, and an outright reorganization of some rail carriers into Conrail. In the face of the possible elimination of air service to many medium and small communities, what similar actions might Congress or DOT take?

Secretary SKINNER. While I agree that further consolidation can be expected in the airline industry, I nevertheless believe that the situation facing the airlines today is quite different than the 1970's railroad crisis. The airline industry today is very competitive. This is true for service to most medium and small communities. In fact, medium and small traffic points have been the prime beneficiaries of deregulation. While further consolidation is likely to result in the loss of some service to such points, most would continue to receive air service. Let me explain the reasons for this conclusion.

Most medium and small communities are linked to the national transportation system through service to connecting hub complexes, usually more than one, and often several. Since a majority of traffic from small communities moves beyond the various connecting hubs, the loss of service to any particular hub would generally not affect either a large number of local passengers travelling to that hub or leave passengers traveling beyond the hub without competitive alternatives. For example, Omaha, a nonhub, receives service to 12 different connecting hub complexes by eight different carriers. In the event any one of these carriers discontinued service to Omaha, the remaining carriers would be expected to continue to compete vigorously for connecting passengers.

The hub-and-spoke system of service enables carriers to compete for very small volumes of traffic. This is the principal reason that smaller communities have done so well under deregulation and also the reason these communities will continue to receive very competitive service even if additional concentration occurs at the national level. To illustrate, again using Omaha as an example, most city-pair markets involving Omaha have relatively small traffic volumes. Nevertheless, except for markets involving connecting hubs, three, four and even five carriers compete for these small volumes of traffic. Between Omaha and Cleveland, for example, five carriers compete for less than 30 daily origin and destination passengers (15 passengers in each direction) over their respective connecting hubs. In a linear system of operation, this volume of traffic would not sustain service by even one carrier. But in today's market structure, increases in national concentration will not necessarily result in inadequate competition at medium and small points.

Mr. **Parker**. What is the Department's view of providing either loan guarantees or direct financial assistance to carriers which are strapped for cash?

Secretary **Skinner**. Not all carriers need financial assistance, which means we would have to pick and choose which carriers would receive assistance. Given the very competitive circumstances in the airline industry today, providing selective assistance may cause distortions in the normal workings of the marketplace that would have undesirable long-run consequences. If a carrier's financial difficulties stem from the inability of the carrier to compete effectively in the deregulated marketplace, assistance is more likely to result in destructive competition, which wastes other carriers' capital resources without enhancing the longer-run competitive outlook of the industry. I believe that carriers that have structurally sound systems will be able to weather the temporary problems that confront them today.

The most productive ways for the Department to enhance competition in the airline industry are to alleviate obstacles to the competitive process, such as inadequate airport and airway capacity, and to take procompetitive actions when reviewing asset transfers.

Mr. **Parker**. Since the return on investment in the airline industry has consistently been less than if funds were put in government securities, it is extremely difficult for airlines to attract investors of any type. Should the government consider serving as the investor or lender of last resort?

Secretary **Skinner**. I do not believe that this would be wise. Over the years the airline industry has been able to raise the capital necessary to expand and I believe that it will continue to be able to do so, particularly if limits on foreign investment are relaxed. The Gulf crisis and the recession, temporary factors which have greatly compounded the current financial difficulties of the industry, should not affect the industry's ability to continue to raise capital needed for growth. One of the reasons for the industry's poor earnings record is fallout from the competitive process of moving from a regulated to a deregulated environment. As this shakeout process winds down and the structure of the industry stabilizes, earnings will improve and enable the industry to continue to attract capital.

Mr. **Oberstar**. The gentleman from Texas, Mr. Geren?

Mr. **Geren**. Thank you, Mr. Chairman.

Mr. Secretary, I know I agree with all the Members that have spoken before. We appreciate the time you take to meet with us and go through these difficult issues with us. I want to bring to your attention an issue we have been talking about.

We have been talking about the big picture. This is a detail. It may not have come to the level of your attention. I think it is an important issue. It does bear on the competitiveness issue and the ability of some of our airport to expand their operations to make service—or provide options for smaller air carriers.

This is the Dallas-Fort Worth Metroplex air traffic plan. It was a fairly innovative plan the FAA undertook, a $40 million plan, that would allow that particular airport to develop a new plan that would increase the usage of that airport dramatically. Last year, the Congress only appropriated $5 million of that $40 million. I do think this is a plan that will provide a lot that can help us meet the growing demands on our air system, not just in Dallas-Fort Worth but other parts of the country as well.

I wanted to raise that issue with you. It may be something that has not been raised to the level of Secretary. I want to make you aware of it and ask for your support in finishing that plan. I think it is something the FAA is trying to do that will enhance the overall air traffic system in this country.

Secretary SKINNER. I am aware of it. Of course, we are—it will be the only place in the world where we have four simultaneous ILS approaches off of the four posts out there. It is a project that obviously has got a lot of potential. It is very sophisticated. The last I knew, it was going forward on a regular basis, and I will look into the funding issue to be sure we deal with it.

It is somewhat unique at Dallas-Fort Worth at this time, because of the way that it is laid out, the way air space is laid out, and the fact that it is true state-of-the-art air traffic.

Mr. GEREN. We thought last year it was going ahead according to plan. Then it was derailed at the last minute. I do think it is an important program. I would appreciate the support of you and DOT as we try to push it forward in this coming year.

Thank you very much, Mr. Chairman.

Mr. Secretary, I have no further questions.

Secretary SKINNER. I thought you were going to ask about Love Field.

Mr. GEREN. I started to do that as well.

Mr. OBERSTAR. The policy on Love Field has not changed.

Secretary SKINNER. No.

Mr. GEREN. Let me say one thing about that. I know the DOT is undertaking a study of the relationship between those two airports there, and I know it is something that you have given personal attention. I would like to say that there are more issues involved in that than meet the eye of the national viewer. The cities of Dallas and Fort Worth entered into agreements a number of years ago regarding the use of the airports that belong and are owned by each of those two cities.

The Wright amendment, as it has come to be called, is consistent with those agreements.

The Department's consideration of this, if you do intend to go forward with your study on it, I would invite you or your representatives to come to our region and give our communities a opportunity to provide the history behind this agreement. We feel it has worked quite well. We feel it has served the needs of our community. The current situation does reflect the general agreement between the communities on which great reliance was placed in the development of that airport and the financing of that airport.

Secretary SKINNER. I understand the issue. I think we have agreed to look at it. This committee, of course, has encouraged me to look at every issue that would enhance competition and allow the consumer to benefit from deregulation and to create competition not only at airports but within regions.

I think it would be irresponsible for me not to study the issue, when a number of people have come to me and asked me to look at it, because they believe they could participate on a more economical basis in the competitive environment if that restriction were removed. We are looking at it. I am not anywhere near the point at which I'll make a decision, but I do want to explain why there are compelling reasons to look at the issue. We have taken no position, as the Chairman said. Obviously, that would be a matter for this committee under any circumstance.

Mr. GEREN. I appreciate that. I wasn't going to bring it up. Since you did, I didn't want to pass up the opportunity.

Secretary SKINNER. I wanted to bring it up because it gives me a opportunity to assure the committee I am looking at all avenues for enhancing competition, holding down prices, and allowing new entrants to participate and grow in the deregulated environment if it is consistent with all the other parameters of the aviation system and the intent of Congress.

Mr. GEREN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

Mr. OBERSTAR. The gentleman from Illinois, Mr. Sangmeister.

Mr. SANGMEISTER. Mr. Secretary, I would like to add my voice to all the accolades you received here today.

Secretary SKINNER. That is what happens when you put all these Illinois people on the committee.

Mr. SANGMEISTER. You will find that out. Also, we are pleased to see another Member from the Illinois delegation is going to be joining you in that Cabinet, a very class act, Mr. Ed Madigan.

Speaking of Ed Madigan, as you recall, it was not too long ago we visited you at your office to voice the concern about the third major airport in the Chicago land area. It is along this line that I would like to ask you a couple of questions.

One, I know you were the mover behind the passenger facility tax, charge, whatever you want to call it. I did not support that. I had concerns about what that might mean as far as the third major airport in the Chicago area is concerned. I see in your written remarks you state that is the new statutory power provided local airport authorities, to initiate a PFC to finance airport expansion.

You go on to say PFCs will allow the industry to expand significantly in the future and anticipated PFC revenue streams can support more than a billion a year in new bonding. Many airports are eager to participate in this program.

The first question I have for you is do you anticipate the money to be raised under that tax to be, as you are indicating, for expansion or do you also consider that to mean new construction for a new airport?

Secretary SKINNER. There is nothing in the statute that prohibits it from being used for a new airport as well as expansion.

In some cases, the old airport will be closed and a new airport opened, because you can't expand the capacity at the existing airport. In some cases like Denver, they may assess the PFC to build the new airport even though it means closing the old airport. As for the Northern Illinois-Northern Indiana area, that study is ongoing. It is in good hands. The committee seems to be working well. We will have to wait and see what the result of that committee process is.

I would only say that the airport authority, if it happened to be the Chicago Airport Authority, the Will County Airport Authority, the Northern Illinois Airport Authority, or the Northern Indiana Airport Authority would have the opportunity to assess those PFCs for the purpose of building a new airport, not expanding an existing facility.

Mr. SANGMEISTER. That is a concern we have. I know you are well aware of the fact that recently a new airport authority was created and signed into law by then-Governor Thompson. Of course, some of the rumor—we should not be dealing in rumor, but it is out there. Chicago, now having the authority to presently levy that tax, that they are going to have heads up when it comes to making the decision, that that is going to be so overpowering that no one else is going to have a chance.

As far as the commission is concerned, not trying to be cavalier, but the way it is structured between Chicago and Indiana, those plus other locations in mind, it is almost a sham.

We are looking to your office, which I know will be there, with that integrity to take a good look at this entire situation. Frankly, there is a lot of work going into—as you indicated—bringing us a proposal. If we can buy it, you know, you are on board with everybody else.

I trust that is still the case, because there are a lot of people putting a lot of time into this. now with the PFC being passed and the way the commission is structured, if we are out of the ballpark, you know, we would like to know. There is a lot of effort being extended to try to put this together. We certainly can put our time to better use if we are not going to be considered.

Secretary SKINNER. Well, I made no decision. I said that before, Congressman Sangmeister. I want to see what the study commission comes up with. There are several sites they are looking at, as you know, in Indiana, Illinois, and Chicago. Some of the sites have severe environmental problems that will have to be dealt with that other sites don't have. Each site has its pluses and its minuses. No decision has been made by the Department or the FAA, nor will it be until we get the results of that study and other things. There is no guarantee what will happen in that process.

I suggested in our meeting that the city of Chicago, in putting forth its site, had put a lot of time and effort into coming forward with a proposal, and that it may very well be appropriate for others that wanted to be considered on a level playing field to do the same thing; and so you are following up on that advice so they can be considered, the pros and the cons.

They will all have to be weighed and assessed. The ship hasn't sailed, hasn't left the dock. The captain hasn't even gotten on board yet.

You know as well as I do the pluses and minuses of all of those sites. We will just have to wait and see. I am sure you will get some disagreement.

We may ask Congressman Poshard to referee this issue as the newest member of the committee.

Mr. SANGMEISTER. Thank you for your honesty and forthrightness concerning the issue.

Secretary SKINNER. As I indicated to you before, it is absolutely essential for the aviation system of this country that we have a new facility in that northern Indiana—northern Illinois area. The entire area will benefit, wherever it is, whether it is Indiana, Illinois, a combination of both, Chicago, downstate, or wherever.

What I want to do is get the process moving to get that facility built. It is long overdue.

Mr. **SANGMEISTER**. Thank you.

Mr. **OBERSTAR**. Mr. DeFazio, the gentleman from Oregon.

Mr. **DEFAZIO**. Thank you, Mr. Chairman.

Mr. Secretary, I admire your staying power before the committee. I am sorry that I had an appointment two hours into your stint. Some of these questions may have been asked.

I am a bit concerned about the emphasis on labor as—identified as a problem in terms of airline costs. I would like to go to a couple of points here and have you expand, if you could. You did point out that debt was an overwhelming problem. I would look at most of the airlines who are in trouble now and wonder whether or not debt, in fact, is more of a factor than their labor costs.

That leads me to the question, I know that you as Secretary have suggested perhaps restrictions on leveraged buyouts would be desirable at one point. You weren't real certain how to intervene in the marketplace. I would, particularly if we are going to enter into this whole idea of foreign ownership, want to look carefully again at what sort of restrictions we place on the acquisition of debt by these—because these aren't necessary to be all capital purchases by foreign interests. Who could see constructs here that could burden otherwise health airlines.

First of all, I have some questions about a leveraged buyout policy.

Second, it seems to me that fuel is one of the most significant recent factors. I don't know a lot about the industry. I am wondering if you have contemplated any intervention there. We have collective bargaining, which we might or might not argue philosophically represents a free labor market with some accommodation to the interests of human capital, but still a free market sort of situation.

When we have fuel and debt hanging out there, I am puzzled that you chose to single out. labor. Well, in terms of pilots, there is a shortage and a growing shortage of qualified pilots projected into the future.

I was riding with a captain who was riding in the coach on United. He was appalled that one of the new hires sitting next to him on another leg of the flight was enjoying her first ride on a jet plane on the way to the interview to go to work for United. He said five years ago that never would have happened.

Secondly, so I would suspect, if anything, we are going to see an upward trend in wages for pilots as the better airlines compete for them. And United, in visiting their maintenance facility in San Francisco, is having a problem hiring qualified machinists or entry-level machinists to fill their ranks there.

I don't think that the human capital costs are the biggest problem. I think perhaps they do, at least for the very qualified people, reflect the bidding of the marketplace and certainly have an influence on collective bargaining, which I support. But fuel and LBOs represent a real concern to me; and I think even a greater potential problem, present and future, for the industry.

Could you address those three points?

Secretary **Skinner**. Why don't we do them in the order in which you brought them up?

One was leveraged buyouts. It is pretty clear the market has reacted. We went through a phase where everybody thought that the airline industry was the way to get rich quick and recapitalize and take a lot of money out. We went through that, as Secretary Brady said, leveraged buyout binge in all areas. That binge is over, as you know, in almost all industries.

A number of the creditors, bondholders, and equity position holders are now taking huge losses as a result of the ill-advised decisions. That is also true in the airline industry. They are restructuring debt, taking a pass on interest payments, dividend payments, sometimes taking stock and equity positions for what was previously debt.

So I think the marketplace has worked in a number of cases. That restructuring can occur. It doesn't appear that it has any long-lasting effects because what is really determining the future of many of these airlines is their ability to build a route structure that is competitive to compete with their competitors and to keep their costs under control.

Costs include jet fuel. There has been no evidence we have seen so far that the spike in the cost of jet fuel was caused by any kind of price-fixing or conspiracies between the oil companies. There may have been a spike in demand throughout the world and in inventorying in Japan and other places that caused it to go up more, but now it is on its way down.

I would suggest that perhaps the best-qualified pilots in the world are flying in the desert right now off of carriers at 100 feet off the ground, flying A-10s and A-8s and F-117s. They are the best-trained, the best-qualified, flying in the most precarious of situations. They are flying not only for their lives but for $20,000-$40,000 a year. There will be plenty of those, hopefully, coming back into the marketplace and they will have the opportunity to compete for the wages.

In the airline business, where you are so susceptible to demand, where your market is so fickle and fungible, you have to do all of the things it takes to make a company successful. You have to build a route structure that makes sense; you have to price your product competitively; you have to expand your system to stay competitive and to keep new equipment in place. It is not only fuel efficient but cost efficient on a revenue per passenger mile.

You also have to keep your costs under control, including labor costs, as well as make sure you have a debt structure that isn't too excessive, and you also have an equity structure and an income stream you can return an investment to your equity investors.

All of that is a very big management challenge. The labor situation is one of those many challenges.

Mr. **DeFazio**. Just to reflect on that point, I only hope we can reward those qualifications with what I consider to be more than adequate wages.

I know that you perhaps have an opportunity to get a ride on the Secretary's plane and probably the pilot there is nowhere near as well paid as someone in the private sector. But that isn't to say we shouldn't pay them all. When I am sitting back in the cabin, I will pay a couple of dollars more if I know that the pilot will land me safely.

In terms of discussing cabotage, the one thing we have to keep in perspective here is we are the largest and most lucrative airline passenger market in the world. And people will go to extraordinary lengths to gain some sort of access to a U.S. carrier to break into the U.S. market.

I am very concerned about us dealing with this, for once, firmly, absolutely, and on a positively reciprocal basis. It has even got to go further than that. We must gain access to the Malaysian market. What good does that do our U.S. domestic carriers when they have just gained access to ours.

A good example is the free trade agreement with Canada, even though they are holding us out of their plywood market. It is one-tenth the size of ours. So there is another thing to be considered here, which is how desirable it is for someone to get into what is an extremely lucrative market and how we gain or lose through that. I know you know these things, but we have just gotten taken to the cleaners so many times.

And I mean it is just like the Japanese. Sure, you can have routes, but you just can't land your planes. Parachute the people out as you fly over Nagoya. There is always a side note, a side bar, or something when we negotiate these agreements. I, for one, am not enthusiastic about the foreign ownership or the cabotage.

Secretary SKINNER. I appreciate your help on PFCs and all your work you did there. I appreciate your thoughtful comments on that.

Hopefully you will find that, if you ask some of the people in the industry, that I have probably been as tough on dealing with some of these issues, as in Japan recently, as any Secretary in history, and I will continue to be so. I am not afraid to take a position that is right as long as everybody understands that.

Mr. OBERSTAR. The gentleman from Illinois, Mr. Poshard.

Mr. POSHARD. Thank you, Mr. Chairman. Let me say I am looking forward to serving on your committee.

Mr. OBERSTAR. I am glad to have you joining this subcommittee.

Mr. POSHARD. Mr. Secretary, I appreciate your participation today. Just two quick questions. If consolidation in the airline industry is the trend for the future, and I think you believe that it is, and we end up with four or five or six major airlines serving this country, I know you have answered this in bits and pieces today among many different questions, but could you just summarize briefly for me why you believe that these airlines would not stake out a certain region or a certain territory and try to maximize their profits by refraining from strong competition in those areas?

Secretary SKINNER. Because they want to expand their businesses. The people who run those airlines want to get bigger and better, and want to grow. And you can't grow in a stagnant market. If you freeze your market, you become stagnant.

You know, if Wal-Mart can become the biggest retailer in the world by targeting the market it wanted to address, so can airlines. They said, "We want to be as big and as great as we can," and they built it into the biggest retailer in the world.

The airline people think the same way. The people who run these airlines don't want the status quo. They have the same attitude that people like Ed Beauvais do.

In the meantime we have got to make sure they have access to the facilities that will allow them to compete. They can have that attitude and still get nowhere if they don't have access. And we also have to make sure that no one obtains an unfair advantage in any of the markets that they compete in.

Mr. POSHARD. Is that something that when you say "we", you are talking about DOT?

Secretary SKINNER. Right. DOT, everybody in this committee.

Mr. POSHARD. One other point in regard to this competition, which is what I am interested in. There are a lot of people in this country today that would say that the domination of the computer reservation system by just a couple of major airlines in this country is very anticompetitive. Do you agree with that? Do you think there is anything that your Department or this Congress ought to be doing to look at that situation?

Secretary SKINNER. Well, we are looking at it in our rulemaking, and our rulemaking should be out this quarter, to deal with some of the problems we face in computer reservation systems. A lot of the problems in computer reservation systems have disappeared when we eliminated biased displays on the terminals. There may be a "halo effect," and I am sure some carriers who don't have them believe there is. We will try to address all those issues in our rulemaking.

Mr. POSHARD. Thank you, Mr. Secretary.

Mr. OBERSTAR. Mr. Mineta? A second and brief round. You have been very patient this morning.

Mr. MINETA. Thank you very much, Mr. Chairman.

Let me go back to your speech of the 23rd of January at the National Press Club, and you seemed to dwell—not dwell, but at least you point out, on the whole issue of the average salary for pilots, copilots, maintenance workers, average salary for maintenance workers, approximately $51,000, pilots and copilots industrywide make $90,000 on average.

I am just wondering, you keep citing the industry's inability to control their labor costs as a contributing factor to the current lag in the industry's financial health. And yet, as I look at other figures and terms of looking at airlines that are paying their employees, for example, at the higher end of the scale, that these are also the airlines that are the strongest competitors: American Air Lines, United, Delta, and so on.

I am wondering how you account for this trend, as to why you in the response here, you keep citing labor costs as a point, and yet sometimes the stronger ones, competitively and financially, today are also the ones who pay on the higher end of those scales.

Secretary SKINNER. First of all, I indicated that the real problems are dealing with the problem of debt, restructuring, ability to grow, and networks. And you have got to remain competitive. These are many of the problems that have caused these airlines to get into trouble.

I would only suggest that costs are an important part of the success of an airline. Their ability to control costs determines profitability.

American is luckier than any other airline except possibly United and Delta in that they didn't go into a recapitalization a few years ago. Mr. Trump made a run on American. United was before the markets when the big collapse occurred. I don't know what the condition of those airlines would be had those recapitalizations gone through at the magnitude that was talked about at that time.

I suggest they would be in a situation similar to those that are in bankruptcy or reorganization today. And but for the circumstances, the times, and a variety of circumstances, it might be different. Those are airlines that have great networks, that have international dimensions, north-south as well as east-west routes, and solid hubs in places like Chicago, Dallas-Fort Worth, LaGuardia, New York, et cetera. Those are airlines that have the ability to raise cash and capital to expand their fleets, because they haven't got debt to service as a result of a recapitalization.

The market is going to be different over the next five years than it was today. They are going to have to compete against each other. They are going to have to face the fact that they have multi-billion-dollar orders of airlines that they want to take delivery of. They are going to have all kinds of costs in their structure that they haven't had today.

They are also going to have to explain to the consumer when they raise their fares, which they will, to meet operating costs, why they are raising them. And I don't want the American people to think when prices go up it is because of a monopoly on a marketplace and deregulation. A good portion of that cost of the ticket will be dictated by how much operating costs go up, how much capital costs go up, how much labor costs go up, and to the degree that you can keep those within market parameters, the ticket prices will stay down.

And if in fact you can go to the market today and hire a fully qualified pilot for $70,000 a year with 727 credentials and qualifications and everything else, then they are available in the marketplace. And if the same person is being paid $125,000 or $140,000 or in the case of a 747 captain, $220,000 a year, to the degree the salary exceeds the market salary, the consumer is going to pay for it. We want the safest pilots in the world, and we have them. We have the best pilots in the world. They are entitled to a fair and justified salary.

That is the only point I am trying to make. I think you are overemphasizing that factor as a cause for the problems in the airline industry. I haven't suggested that it has sofar. I suggest that will be one of the factors that will determine how much the price will go up in the next several years.

Mr. MINETA. You seem to indicate in that same speech that if the airlines went with the Labor Act, that would help also.

Mr. SKINNER. If there was more parity in management-labor relations. It appears to me, if collective bargaining is going to work, that management ought to have a right to assess the cost of a strike, and to act on that assessment. And when airline heads come in and tell me strike is not an option for them, while it is an option for organized labor, because airlines can't afford to take any strike because it will put them into bankruptcy, there may be some lack of parity.

Mr. MINETA. Are you better served under NLRB?

Mr. SKINNER. First of all, the National Mediation Board is making great progress in allowing people to make that decision.

Mr. MINETA. When the NLRB said, we ought to have—in looking at Eastern—a different approach, and we ought to take—jump into the middle of that, the Presidential Emergency Panel got turned down.

Mr. SKINNER. What we talked about is a PEB with a congressionally dictated or mandated salary compensation schedule. We believe the free marketplace should work.

Let me say that I think the real future of the airline industry is employee participation in the equity and in the ownership of airlines. In the successful airlines, the new entrants, America West and Southwest, both have their employees involved with management in all aspects of the airline.

And I think that's the real potential for the airline industry, including the giants, like American and Delta and United. That's going to determine how successful they are. And the employees will buy into the airline and participate in the growth of that industry.

Mr. MINETA. Thank you.

Mr. OBERSTAR. The gentleman from Mississippi, Mr. Parker.

Mr. PARKER. I think it is important that the American people start understanding what deregulation has done, and we start talking about the limited number of carriers. I think when a discussion was taken several years ago about deregulation and more competition, everybody looked at that time from the standpoint of more competition means there are going to be more players on the field.

Well, there aren't more players on the field. And even Members of Congress are having to finally put themselves in a position of understanding that we are not going to have that competition out there. And it makes you look at it completely differently. I have never understood why people who believe so strongly in deregulation—and I do agree with deregulation—feel that bureaucrats who put on recommendations that didn't make sense all of a sudden became so smart that they could take off those regulations and know which ones to take off. I have always been fascinated that people who would understand that, would think that the bureaucracy could do it.

I think we have tremendous problems in our aviation industry, and it has been occurring for a long time. And I think before we see this thing heal itself, I think the American public are going to finally realize the situation of it.

I won't take any more time. I have gotten in enough trouble this morning already.

Mr. SKINNER. All right. I think all I would say is that all you have to do is go to an airport today and see somebody who is traveling for $159 round-trip or is on a companion fare or a variety of the other fares that are available, to see just how competitive pricing is. The consumer, from every statistic that has been analyzed by anybody on a nationwide basis, is benefiting more from deregulation than they ever have since deregulation, and all you have to do is put the statistics to it and look at some of the prices that people are paying.

Go to the West Coast, Congressman.

Mr. PARKER. Mr. Secretary, I am looking long term. The problem with our—in our Government is that we are so short-sighted. Our business community is so short-sighted; they don't look 20 years down the road. And that is the problem we have.

We are looking at a transition phase. This is not the long term. When I look 10 years down the road and 15 years down the road, the transportation system that we have now is going to be the result of what we have gone through. We are not at the end; we are just in transition. I am worried about 10 years from now.

You are telling me that everything is getting better now, that consumers are well served. If you are able to tell me that in 10 years, then I will say, I am sorry, I am wrong.

I will bet you I am not wrong. In 10 years we are going to pay the price. That is what I am referring to.

Thank you, Mr. Secretary.

Mr. SKINNER. All I would say is, if we look at the ability to expand the aviation system, to attract capital, to take advantage of markets wherever they exist on a level-playing-field basis, you will have that competitive airline industry in the future.

Mr. OBERSTAR. Mr. Secretary, we are about to wrap up here. Mr. Lipinski has one comment he wants to make.

Mr. LIPINSKI. I just have 30 seconds. I just want to say, I don't agree with Congressman Sangmeister that the commission that is set up in Illinois and Indiana for an airport is a sham, because it know that Secretary Skinner would not appoint a sham commission.

Thank you.

Mr. OBERSTAR. Mr. Secretary, I must compliment you. A year ago, two years ago you started in this venture with this committee, you were learning the trade.

You were a quick learner. Your answers today and your composure for two-and-a-half, almost three hours before this committee have been remarkable; and your grasp of the subject matter has deepened, your knowledge of domestic and international affairs broadened.

But of the issues that government can address as a believer in the industry today—cabotage questions, fuel cost increases, short-term liquidity problems—there is only one the Department has addressed so far, and that is the liquidity issue, opening the way for investment. That, I understand, is going to be more limited now in terms of the instant decision.

There is one that the Department and the Administration could address, that the industry has expressed concern about, and that is the 2-percentage-point increase in the ticket tax. There could be a suspension of that tax, pending the current recession, the current financial problems of the industry, and the outcome of the conflict in the Middle East.

There are plenty of national security grounds for doing so. The industry has given its aircraft to CRAF; it has made sacrifices. Our competitors in some respects are moving in on the inability of U.S. carriers in all respects to use their ability to compete in international affairs because they have given aircraft to CRAF. That's a matter that you might want to take a lead on with the Administration.

Mr. SKINNER. Those whose aircraft are used in CRAF are compensated, I hope, on a fair and equitable basis. Of course, the Federal Government plays a role in CRAF.

Mr. OBERSTAR. That compensation does not compensate them for losing business. In some cases, they will. JAL, for example, could put more aircraft on a route than U.S. carriers in the same route with fewer aircraft.

Mr. SKINNER. Right now I would add that, given the volumes throughout the world, nobody is putting more aircraft on. If they are, they are going to be losing money.

But the Administration looked at the idea of suspending the ticket tax. That would be an indirect subsidy, and it did not meet with a great reception.

Mr. OBERSTAR. I would consider it a subsidy, since withholding the tax for a time, pending the cessation of hostilities, clearly where the war is indeed causing, despite the significantly elevated security, far greater risk to pipelines than airlines. It just makes some sense. I would suggest reconsidering that judgment.

Finally, if airlines are, as you have said again and again, such a poor investment risk or opportunity for investors that we need to open the markets to foreign investors, what I am wondering is, are those foreign investors lambs only waiting to be fleeced or do they know something more about our market than we do? Or are they interested in looking for something more than a fair return on their investment dollar, like control, like backdoor entry to U.S. markets?

You see, that is the broader context in which I believe the question of liquidity should be addressed in cross-border investment, the context of an international regime. I think we could make a good start on that with Canada.

I think we need to make continued negotiated efforts with the European Economic Community as they move toward a single market at the end of this year.

Mr. SKINNER. I appreciate your support of our efforts to explore the Canadian-American initiative. I think it will be a good laboratory for what we might do or not do or might consider in the future. And I would suggest that, even though we redefined our investment restrictions so far I haven't seen a rush of foreign investors beating the door down to invest in airlines.

The KLM investment had been made prior to Desert Storm, so I think we are going to have to wait to see the impact of that until after we return our troops home.

Mr. OBERSTAR. The Dutch do have, at least on paper, a more open regime on investment and trade with the United States. Others do not, and before any other judgments are made, we need to look at their investment situations.

You have been very generous with your time, Mr. Secretary. This has been a landmark hearing, and we appreciate your participation and look forward to a splendid, continuing cooperation.

Mr. Skinner. Thank you. As we get through these periods, I think we will need to work closely together, so we can avoid the circumstances that Congressman Parker talks about.

Mr. Oberstar. Thank you.

The subcommittee will take a 40-minute recess.

[Recess.]

Mr. Oberstar. We have a number of statements from Members for the record at this point.

[The prepared statements of Messrs. Hammerschmidt and Payne follow:]

STATEMENT OF HON. JOHN PAUL HAMMERSCHMIDT

Mr. Chairman, I want to thank you for holding this hearing. It could not be more timely. Airline results from last year are beginning to come in and the picture they paint is not a pretty one.

It appears that airline industry losses for 1990 will total about two billion dollars. This is clearly the worst loss in airline history. It is more than double the previous record loss of $733 million dollars in 1982.

The airline industry is being squeezed by rising costs and declining revenue. The costs of fuel and labor are higher at the same time that passenger traffic is being reduced by the recession and fears of terrorism.

In my discussions with representatives of the airline industry, there is clearly concern about the future. They worry that one more problem could push some over the edge. Given the fears of passengers that already exist, just one terrorist incident could scare even more people away from air travel.

Together with our chairman, Jim Oberstar, I was a member of the President's Commission on Aviation Security and Terrorism. I have also attended several recent security briefings by DOT and FAA officials. I must say that I am heartened by what I have seen and heard recently.

Although the threat is greater, the level of security is higher as well. As a result, I believe people should be reassured about the safety of flying. Of course, one can never provide a 100 percent guarantee. However, the public perception of the danger seems to be out of proportion with the actual risk.

It is my hope that in this hearing, we will thoroughly examine the current problems of the airline industry and discuss possible solutions. I recognize that the problems are complex and solutions will not be easy to come by. But I am confident that the witnesses here today can point us in the right direction.

Thank you, Mr. Chairman.

HON. LEWIS F. PAYNE, JR.

Mr. Chairman, since this Subcommittee last met, numerous events have occurred in the airline world. Eastern has closed its doors; Continental and Pan Am have filed Chapter 11 bankruptcy; and 1990 saw some of the worst financial losses ever for the airline industry.

Of course, we are all concerned about the recent events and question whether or not they are in any way the result of deregulation. Of the 22 major new entrants since deregulation, only four have survived. And the established airlines are increasingly experiencing financial difficulties. Worst case scenarios see the industry possibly being reduced to three or four major competitors.

In light of the recent events, it is time for us to seriously explore the health of the airline industry. In the last Congress, we heard of the barriers to entry that exist in the airline industry. Legislation to diminish these barriers has been enacted, and it is too early to determine whether or not these measures have been successful. However, in light of the recent events in the airline industry, I appreciate this opportunity to further examine the financial condition of the industry and the adequacy of competition. I welcome our witnesses who are with us today and look forward to hearing their testimony.

Mr. Oberstar. The Subcommittee on Aviation will come to order.

We resume our hearings this afternoon with apologies for the intervening votes that kept us 20 minutes longer than the Chair announced earlier with our panel consisting of Mr. A. Maurice Myers, Chief Executive Officer, Aloha Airlines; Mr. Edward R. Beauvais, Chairman and CEO, America West Airlines; Mr. Elliott Seiden, Vice President, Law and Government Affairs, Northwest Airlines; Mr. Raymond J. Vecci—a great Italian name—Chief Executive Officer of Alaska Airlines, and Mr. Richard Mathias, Senior Vice President, Government Affairs for Pan American World Airways.

Let us begin then in that order.

Mr. Myers.

TESTIMONY OF A. MAURICE MYERS, CHIEF EXECUTIVE OFFICER, ALOHA AIRLINES, INC.; EDWARD R. BEAUVAIS, CHAIRMAN AND CEO, AMERICA WEST AIRLINES; ELLIOTT SEIDEN, VICE PRESIDENT, LAW AND GOVERNMENT AFFAIRS, NORTHWEST AIRLINES; RAYMOND J. VECCI, CHIEF EXECUTIVE OFFICER OF ALASKA AIRLINES; AND RICHARD MATHIAS, SENIOR VICE PRESIDENT, GOVERNMENT AFFAIRS FOR PAN AMERICAN WORLD AIRWAYS

Mr. MYERS. Thank you, Mr. Chairman.

I submitted written testimony and I will summarize for you now.

Mr. OBERSTAR. The Chair would like to announce all written statements, prepared testimony, accompanying documents, will be included in the record in full.

Witnesses may summarize their statements in full assurance that not only will their document be included in the record, but it has already been read.

Mr. MYERS. Thank you, Mr. Chairman.

Mr. OBERSTAR. Thank you for submitting your testimony in advance.

Mr. MYERS. Aloha rarely feels strongly enough about industry-wide issues to appear at a congressional hearing, but the department's recent change in its foreign control doctrine prompted my appearance today.

The process by which 50 years of precedent was changed was one of undue haste and I would like to think Aloha's considerable effort to unearth the true facts about the pervasive Japanese control of Discovery Airways is an important part of that precedent.

I would hope the department and the subcommittee both stop to ask what is the long-term purpose to be achieved by the Department's sudden policy change? It is said that foreign capital is the only capital available to certain U.S. carriers.

I don't believe that for a moment. Those carriers with good track records can get capital and the weaker carriers are unlikely to find capital from either U.S. or foreign sources.

Nevertheless, Aloha is prepared to consider a change if there are identifiable incremental benefits which U.S. carriers can obtain in return for this important change in policy. Any such change must also address the cabotage issue. At a minimum, I would hope open access and allowing reciprocal U.S. investment by the particular foreign country involved will be required.

I would also hope that certain percentage limits are imposed on the total amount of equity, both voting and non-voting which a non-U.S. investor may acquire in a U.S. carrier.

I would also hope the U.S. carrier is required to make a genuine showing the carrier is not and will not be subject to the domination of foreign interests.

For someone doing business in Hawaii, I am obviously very sensitive and familiar with Japanese investment. I know and you know that a U.S. airline investor would not only be unwelcome in Tokyo, but that the Japanese airlines in conjunction with the appropriate Japanese ministries would find ways to frustrate any sizeable U.S. investment.

I think the discussion today about obtaining slots in Japan is a good example of the kind of problem we have run into when trying to serve Japan.

In addition, we all know the U.S.-Japan Aviation Bilateral Agreement is one of the most restrictive the United States has.

Aloha has been trying for a number of years to obtain entry to the Honolulu-Tokyo market, one of the largest markets in the entire world. If there was ever a market that justified open entry, it is this market.

Yet for the Japanese, there is always some excuse or reason why it cannot be done now.

With this background showing our frustration because Aloha has not been successful in busting out of our local markets to serve Tokyo, which would be a natural for Aloha—and I should interject we have had an office in Tokyo for 27 years and one in Osaka for nearly as long—the last thing I am prepared to see is a new entrant carrier financed with Japanese funds serving the local Hawaiian markets.

I sincerely hope you underscore to DOT that Japanese investment is not the same as Dutch investment.

I heard some of that here this morning. That pleases me.

I certainly hope you underscore to DOT that time and time again the Japanese Government will make concessions to open up its markets only after the Japanese Government has exhausted every delaying tactic.

Let us not give them even less incentive to open up their markets which I am extremely concerned may be the result of DOT's policy.

My second concern is the inherently biased criteria DOT uses to make international route awards. These criteria as more fully explained in my written testimony favor the larger carriers and disfavor the smaller carriers.

Aloha, in essence, was told the decision on which carrier would become the third U.S. carrier in the Honolulu-Tokyo market, one of the largest in the world, should be determined not by which carrier proposed the most service or the lowest fares, because that was Aloha. Rather that decision was determined by which carrier was prepared to operate single plane service between Houston and Tokyo, a routing which involved enormous circuitry and added travel time vis-a-vis many existing routings between Houston and Tokyo.

Aloha found its Honolulu-Tokyo service was discounted by the Department because Aloha did not yet own and operate 747 aircraft.

In other words, unless a carrier is willing to take an $80 million gamble on what DOT's decision will be, that carrier is going to be heavily penalized in the selection process. Yet investment of that type would have been illogical and highly imprudent.

Aloha did not get where it is by being imprudent. We could have obtained the appropriate aircraft had we received the Honolulu-Tokyo route award. The ultimate irony is Continental, that received the award, attempted to sell its brand new Honlulu-Tokyo route less than six months after it started service.

That, of course, raises the issue of the Department's route transfer policy issue. That is weighted in favor of the largest carriers with the deepest pockets.

If well-run, smaller carriers are to survive, the large carrier bias in DOT's policies has to change.

Thank you.

Mr. OBERSTAR. Thank you, Mr. Myers. Particularly, I appreciate that reference to the Continental issue.

Next, Mr. Beauvais.

Mr. BEAUVAIS. I, too, have a summary that I would like to go into.

By way of background, America West is one of the two remaining post-deregulation carriers. We began operations as a new entrant airline in August of 1983 with three Boeing 737 aircraft.

Since that time, we have grown dramatically increasing our fleet size to 104 aircraft and a total employment of 14,000 people.

In January of 1990, America West was recategorized by the Department of Transportation as a major carrier six-and-a-half years after our inaugural flight.

We have every intension of expanding further, both domestically and internationally. However, for this to be possible, there is an important role for the Federal Government to play.

Indeed, Mr. Chairman, if help is not forthcoming soon, the condition of the U.S. airline industry could be irreparably harmed.

The airline industry has been plunged into a depression. We have one major carrier being liquidated, two in bankruptcy, and yet another that has declared a bond holiday, all in the face of record losses across the industry, weak and strong alike.

In fact, if these losses continue, the industry could lose its entire net worth by the end of 1991.

While the problems confronting the industry are inter-related, I would divide them into short-term and long-term.

Short-term crisis is the direct result of the events in the Persian Gulf and our country's policy regarding those events.

While I am confident I speak for most, if not all, in the industry in support of those policies, I believe it is clear we as an industry have suffered a disproportionate share of the burden of the Middle East conflict.

First came the tremendous increase in aviation fuel prices, an increase greater than that of other fuels. Then came the tremendous drop in travel as a result of a perceived terrorism threat.

When this is laid on top of the recession and too soft traffic, we have all the elements needed for the liquidity crisis the industry now faces. This situation must be urgently addressed either legislatively or administratively if we are to avoid unnecessary contraction in the industry.

However, it should be carefully done so the long-term competitive structure of the industry is not weakened. In this context, I am very skeptical of the two remedies currently being touted as solutions to today's problems, those being increased foreign investment and the sale of international route authority.

While there may be reasons to allow an ever-increased foreign investment in the airline industry on a reciprocal basis, this remedy will not be timely enough to deal with the urgent problems created by the Persian Gulf conflict.

In addition, there are a number of other factors to consider.

Unlike other nations, air transport has become our nation's chief form of inter-city mass transportation and is, therefore, vital to our transportation system.

Also, we must keep in mind the combination of a weak dollar and low equity prices result in artificially low airline stock prices. Any change in the rules on foreign investment should occur only after a careful and comprehensive review designed to assure the benefits will exceed the costs of such a change.

I believe the frenetic activity underway in the international route sale arena will inevitably result in long term costs that exceed the short term benefits. In analyzing these proposed transfers, they should not be allowed to undermine the policy reasons for awarding these routes in the first place.

One must ask the question: If this were a route case, would all the routes or the additional authority be rewarded to the carrier involved?

Given the importance of international routes to an airline's ability to compete effectively in the future, the long-term competitive impact must be carefully analyzed.

I would direct your attention to Pan Am's sale of its Pacific division and Eastern's sale of its Latin American division. I question whether these transactions have increased the long term competitive status of either Pan Am or Eastern.

Indeed, I cannot think of such a transaction that has resulted in a healthier competitor long term.

Having said this, I believe there is a legitimate public interest in assuring that liabilities that may attach to the Federal Government such as pension benefits or taxes or the interest of creditors are satisfied to the extent possible.

In our view, there are alternative mechanisms which could be created to address this concern. One such mechanism could involve something like a sharing of the proceeds between the transferee and the Federal Government.

I am sure other mechanisms could be developed. However it is done; every effort should be made to achieve an equitable distribution of international routes if one is interested in a diverse competitive industry over the long term.

Another point made this morning that I think is absolutely vital is the U.S. domestic industry represents two-thirds of the entire world aviation industry. We are not talking about an international arena that is much larger than our own domestic.

We ought to be able to solve our own problems domestically before we look around the world in terms of our global ambitions.

If we are to have such a competitive industry, additional steps must be taken to create a level playing field. It is no accident that the two major players in buying international routes, American and United, also control the two dominant computerized reservation systems.

The failure of the Federal Government to deal effectively with this problem has caused substantial distortions in the industry. A tremendous amount of work has already been done in this area.

In this regard, a study done by DOT in 1988 found that CRSs are typically double the cost of providing the service. Based upon the work done by DOT, American Airlines, for example, receives fees in excess of costs amounting to $215 million per year.

In addition, they receive over $328 million per year in higher airline revenue due to the so-called halo effect.

This gives American a yearly advantage over its competitors of approximately $1 billion which has little, if anything, to do with actual airline competition.

Based on this DOT work, the amount mentioned above, $382 million, was pure profit. United has a similar advantage.

In response to this, the owners of these systems ask why shouldn't those who invested in the CRS be able to reap the benefits of that investment?

That begs the question. Those who invested will continue to receive considerable benefits for their investment.

The real question is should the interest of those companies take precedence over the interests of American consumers?

Left unchecked, CRS monopoly power would inevitably reduce the number of competing airlines because of the continuing transfer of wealth. We think that that is at the foundation of the discussions this morning about the industry contracting to as few as four airlines or at least between four and seven carriers.

Another area ripe for anti-competitive practice is that of airport access. This is particularly true at the concentrated hubs and the high density traffic airports. Because of agreements made between dominant carriers and their airports, carriers with no presence at these facilities have difficulties getting facilities.

Hopefully, the legislation offered by this subcommittee will soon begin to address this problem but it will remain a competitive barrier for the foreseeable future.

Much has been said regarding the situation of the so-called slot-controlled airports.

America West is optimistic the provision in the same legislation I just referred to calling on DOT to initiate a rule making designed to facilitate access by new entrants at the high density airports will satisfactorily solve these problems.

Suffice it to say, there is no evidence indicating that the current rule is providing for new entry. It is difficult to have a truly national airline if one does not serve several of the nation's top airports.

Mr. Chairman, I am convinced that a failure by the Federal Government to act now may well eliminate the options which currently exist to preserve competition and the many benefits of airline deregulation. A consolidation of the industry into three or four carriers will result in higher fares and service dislocations, leading to irresistible pressure for the return of route and rate regulation or the surrender of some of our domestic market to foreign competition.

I am equally convinced that prompt action to address the short-term liquidity problem and long-term structural problems will result in a healthy domestic airline industry and assure that Americans continue to enjoy the benefits of airline deregulation.

Thank you.

Mr. **Oberstar**. Thank you, Mr. Beauvais.

You have concisely summarized the testimony submitted in more detail. We appreciate your comments.

Mr. Seiden?

Mr. **Seiden**. Thank you, Mr. Chairman.

We appreciate your giving Northwest the opportunity to appear before you this afternoon and commend you for your leadership in calling these hearings so promptly on this very important subject.

Before addressing the major—and important—topic of this hearing, I would first like to report on the front-line role the airline industry is playing in Operation Desert Storm. As part of the Civilian Reserve Air Fleet (CRAF) program, U.S. airlines have carried over 60 percent of all troops and over 20 percent of all cargo to the Middle East. Northwest, and I am sure I speak for the entire airline industry, is pleased and proud to be a part of this effort.

The airline industry has been a proud participant in our war effort, but it has also been a casualty of the war.

Even before the outbreak of the war, the recession had substantially dampened both business and personal travel by air. Since the outbreak of hostilities in the Middle East, demand has dropped even more precipitously. The U.S. airline industry, in cooperation with the FAA and domestic and international airport authorities, has taken extraordinary steps to increase security to protect our passengers. These measures, we are confident, provide our passengers the highest level of security.

Nonetheless, discretionary vacation travelers and even business travelers now have been canceling or postponing their air travel plans. International air travel across the Atlantic and Pacific has plummeted. We have been forced to cut our overall service to international destinations by 17 percent, including flights to London, Paris, Frankfurt, Tokyo, and Seoul and Taipei. Other U.S. carriers have had to cut back as well.

In addition, in the months following the Iraqi invasion of Kuwait, airlines faced dramatically increased costs of jet fuel. Notwithstanding the abundant worldwide supply of oil, speculation and the fear of a shortage drove the price up to more than double the pre-invasion levels. The price of jet fuel rose faster than the price of crude oil, and even though the price has dropped in recent weeks, it still remains 15 percent higher than the price prior to August 2nd.

Furthermore, the airline industry bore the brunt of the fuel price increases: while the prices of wholesale gasoline and home heating oil increased 38 percent and 65 percent respectively, jet fuel prices rose 120 percent during the same period.

Finally, the ability of the industry to attract capital has been seriously hampered due to the savings and loan and banking crises.

The cumulative result of the convergence of these events has been an unprecedented level of industrywide losses. During the fourth quarter of 1990, as we have heard repeatedly in these hearings already, virtually every carrier lost money and the industry as a whole lost approximately $1.7 billion, raising the total 1990 losses to over $2 billion—more than double the industry's previous record loss during the recession in 1982.

The problems which plague each airline vary. However, the overriding threat to the long-term viability of even the healthy carriers is the difficulty of capital formation during this turbulent period and perhaps beyond.

The need to raise capital is particularly critical in the airline industry. Simply put, airplanes are expensive. For example, the average cost of a new Stage 3 aircraft is approximately $44 million. Yet, airlines must order aircraft years in advance of actual aircraft delivery tailored to passenger traffic years in the future.

The capital formation problem predates the Iraqi invasion of Kuwait, although the crisis in the Gulf has certainly exacerbated it. The industry has difficulty raising capital mainly because the industry has not been profitable. Investors, both large and small, are simply not interested in investing money in a company, or in an industry, that does not provide a fair return on investment.

Let me cite some chilling statistics. The annual rate of return on investment has been 6.65 percent. By comparison, during the same period the rate of interest on a risk-free United States Treasury certificate has ranged from 7 to 14.5 percent. Therefore, an investor would have been far better off by taking no risk at all and investing in U.S. securities than by taking a risk and investing in the airline industry.

Unfortunately, those who have invested in our business have found all too often that the risks are very real.

The financial state of the industry belies an oft-stated public perception that airline fares are excessive. The Department of Transportation, in an exhaustive study released in February 1990, determined that since deregulation, inflation-adjusted yields have decreased. The General Accounting Office, as recently as this past November, concluded that since deregulation even fares at small and medium-sized airports had decreased on an inflation-adjusted basis.

However, for us, to paraphrase, "the proof is in the profits" or, in our case, "the lack of profits." If the current industry structure were an oligopoly, as many have claimed, or a monopoly on many routes, the industry would be making money rather than registering record losses.

The overall lack of profitability of the industry also discredits the concern that fares and the percentage of enplanements are higher at so-called "fortress hubs." The critical—and we submit only relevant—issue is whether the traveler has a choice of service among competing airlines for reaching a particular destination.

As shown by the DOT, since deregulation, consumer choice has significantly increased in terms of frequency, timing and routing of flights. DOT has noted that more than one-half of all passengers traveled in markets with three or more competitive carriers in 1988 compared with only one-quarter in 1979.

Even at our largest hub, Minneapolis/St. Paul, Northwest faces competition from 18 major and regional carriers providing competition on virtually every route we service. And the competition is real. If American or United cuts its fare from Minneapolis to Washington, DC, or America West cuts its fare to Las Vegas or Phoenix, Northwest will need to match that fare and service—or lose the business.

Congress must recognize the precarious financial state of the industry, and the fierce competitive environment. We are concerned that Congress did not do that; less than three months after the Iraqi invasion, it enacted legislation which placed an enormous additional financial burden on airline passengers and our industry.

We intend not to criticize but to emphasize the trauma we are experiencing. As I stated at the outset, we are an industry that is a casualty of the war. We find ourselves literally in a traumatized state. When dealing with a shock trauma victim, the first and only order of business is stabilization. Surely you would never think of introducing additional stress, no matter how minimal, until the victim were stabilized.

These hearings are welcome and timely. The crisis in airline transportation has occurred so rapidly as to be breathtaking. The first order of business for the Congress should be to ascertain the facts regarding the state of the airline industry. These hearings are exactly the right way to do that. We believe an objective analysis of those facts will lead the committee to conclude, as we have, that trauma is indeed the appropriate word to use to describe the state of affairs today in the airline industry.

Issue recognition is the first critical step. Once there is recognition that this critical infrastructure industry is in trauma, we are confident ways can be found to address with this committee the creation of governmental decisions and policies that are appropriate to achieving industry stabilization.

Mr. Chairman, we appreciate this opportunity to appear before you. Thank you.

Mr. OBERSTAR. Thank you, Mr. Seiden. We appreciate your testimony, not only the delivered testimony but the complete document, which is very enlightening.

Our next witness, Mr. Raymond Vecci of Alaska Airlines.

Mr. VECCI. Thank you, Mr. Chairman.

We know we are not a household word back here. I would like to give you a brief sketch of Alaska Airlines together with our sister airline Horizon Airlines.

We just exceeded $1 billion, in revenues in 1990. Our system serves Alaska, Washington, Idaho, California, Arizona, and New Mexico. Alaska Airlines has approximately 6,000 employees and Horizon another 1,900. Alaska Airlines along with United and Frontier was among the first carriers to support deregulation.

We recently completed our 18th consecutive year of profitability. On the West Coast we have developed a reputation for excellent service and have been recognized for this. We represent about 1 percent of the industry's market share.

For the lack of any better explanation, the very existence of an airline our size is attributed to being a niche carrier. We have great difficulty in identifying with this designation when our primary competitors are United, Delta, and American.

We have no unique advantage. We are faced with huge and ever-increasing structural disadvantages. The carriers we compete against keep growing larger and larger as a result of consolidations through merger or failure of other carriers, the geographic dominance of huge hubs across the country, their marketing control of the distribution system through CRS systems and travel agencies, frequent flier programs, and incentive commission programs.

Public facilities in the form of gates and slots are locked up. Indeed, only this month after five years of service to Los Angeles have we been able to obtain our own gates at Los Angeles, and that was only through a private transaction.

In the name of deregulation, the industry has been transformed to one dominated by a handful of carriers. The dominance continues today in the form of further failures and the purchase and sale of international routes.

In the name of deregulation we have had passive government policy while this happened. Indeed, anyone raising a case for government involvement, however minimal, is branded as favoring reregulation. To a large extent, there is already reregulation today: ad hoc regulation imposed by the industry giants. It seems that all the concentration that has taken place can be explained away by academic theoreticians, government policymakers, and the so-called mega carriers. I guess now they are called giant mega-carriers to distinguish them as a result of market forces at work.

It is not our purpose to debate the reality of today's competitive environment. It can't be undone. Nor is it our purpose to urge reregulation or special protection for small carriers such as ourselves. We cannot delude ourselves to believe that a small carrier such as Alaska will not always have huge hurdles to overcome in competing against the giants.

We do, however, find it astounding that after so many years of study, our government continues to stand by passively and throw up its hands at the monopoly represented by the CRS systems controlled by the mega-carriers. With one exception in the purchase of services, facilities, equipment and material, we have the ability to obtain competitive pricing. Even for fuel, we are able to deal with competitive vendors. The exception is CRS vendor charges. We have no choice but to participate in these systems, and the charges are imposed at whatever level the vendor chooses, even though the very marketability and attractiveness of these systems are enhanced by the inclusion of our schedules and pricing.

Despite cries, all we have seen is tinkering. We strongly urge a remedy, whether it is divestiture or a system to compel negotiations and arbitration of these fees.

We believe the subject has been studied and restudied for too long. Our goal to continue to be an independent, successful carrier is unwavering. We are not asking for protection, reregulation or any special treatment. We are, however, asking you to address this most important repugnant form of monopoly pricing. The fact we have been successful so far is not an argument to allow the present largely unregulated system to continue.

Thank you, Mr. Chairman.

Ms. Horn [presiding]. Thank you, Mr. Vecci.

Mr. Richard Mathias.

Mr. Mathias. We appreciate the opportunity to appear before the committee at what is the darkest hour of the U.S. airline industry. I was particularly concerned to hear the Secretary of Transportation this morning indicate to the committee that deregulation would still be a success and competition would still prevail throughout the country and world if there were only five U.S. airlines remaining, because I have the awful feeling that certainly me and probably none of the people at this table are among that five. So this may be a farewell appearance.

Nevertheless, I still will be brief.

The industry has a number of long-term problems, but right now the greatest long-term problem is surviving the short term that is in front of us.

Pan Am's own financial problems are well known. What you ought to realize about these problems is that they are no longer unique to Pan Am. Because of the Gulf crisis and the war, every U.S. airline is experiencing a severe financial crisis to one extent or another. The real issue before this committee, the entire Congress, and the administration is what will our air transportation system look like in 1992 and beyond? That question has to be answered in the next few months.

Let me describe just briefly the extent of the present crisis. The Air Transport Association and other carriers can better address the current financial position of the U.S. industry as a whole. But at least there are two points worth noting. First, it has never, ever been as bad as it is right now.

Second, the majority of U.S. airlines are desperately short of working capital and are experiencing negative cash flows.

As Pan Am can testify on the basis of its own experience, once an airline is in this cycle, this downward cycle, the rapidity of the decline leaves few alternatives other than the disposition of assets, the limitation of operations, the layoff of employees and ultimately the Bankruptcy Code in an effort to reorganize.

The causes of the financial crisis are several. The U.S. airline industry is unfortunately in a position to become the most significant commercial casualty of the war. Air transportation is energy-dependent, and the enormous increase in the price of jet fuel gave rise to previously unmanageable losses during the fourth quarter of 1990. For Pan Am alone, the fuel price increase resulted in additional expenditures of over $140 million more than normal during the five months of August through December of 1990.

And even though there never was any shortage of either crude oil or refined jet fuel, the so-called "free market" has still not returned prices to normal or justifiable levels. For Pan Am, which buys proportionately more fuel at foreign points where fuel prices are higher than in the U.S., our system average price is still 50 percent higher than it was last July before the Gulf crisis began.

The second principal cause of the industry's financial crisis is the recession. Although we can't quantify the economic effect of lost revenues as precisely as we can measure the cash drain of fuel cost increases, the downturn in the economy in the United States and Europe has been a serious blow. The recession has severely reduced traffic and made it impossible to pass through to customers the higher costs of fuel.

Also, the deep concerns of individuals, families, and business of all sizes about their financial stability contribute to an alarming reaction to the threat of terrorism, which is the third principal cause of the industry crisis.

As you know, air transportation is dependent to a very substantial extent on discretionary travel, people who don't have to go but decide they want to take the trip based upon personal reasons. Indeed, we are now seeing that even the bedrock business travel is to a significant extent discretionary. Pan Am has previously felt the consequences of indiscriminate terrorist brutality. Now the entire industry is feeling those consequences.

We understand that transatlantic traffic on all airlines is down over last years by approximately 50 percent and most if not all of that is attributable to the war and the threat of terrorism.

The following statement in my testimony is in error. Transpacific travel is down from what I understand to be 10 to 15 to perhaps 20 percent. It is heading south. It is not yet at the 50 percent level that has hit the transatlantic market.

Internally within the U.S. in several markets like Chicago to San Diego, the domestic consequences have not been as great as the international routes. The downward trend is still very substantial. Go out to any airport and look around. At peak times at every terminal, it looks like very early Sunday morning.

The safety worry is not going to be resolved immediately by a coalition victory in the Gulf. Indeed, because of the perverse nature of terrorism such a victory might actually exacerbate the problem for a period.

What about the consequences of increased concentration? Look at prices and service. At the consumer level, the most obvious result of increased concentration will be higher fares, both through actual increase and the decreased availability of various types of discounts.

There are few industries today that are as price competitive as the airline industry. The types of marginal cost pricing originally envisioned by the drafters of the Deregulation Act exist because of the smaller airlines and the actual and potential competitive threat they pose to the Big Three. But as the industry concentrates and becomes a tightly-knit club, that is going to disappear. From the standpoint of fares, you simply must have competitors to have competition.

From the standpoint of service, there is unlikely to be a shortage of total capacity, but the question is how and where that capacity will be deployed? The saving grace, from a service standpoint, of the post-deregulation hub and spoke systems is that there are so many hubs—more than twenty. As many of those hubs are weakened or abandoned, more and more communities, many of them large, will find themselves with highly inconvenient connecting service in even their largest city-pair markets.

Let me just add to my written testimony something that I was reading this morning when I was looking through the current issue of Business Week, although it is dated February 11.

You understand how these magazines go. It is really two weeks earlier news. This is not news.

This is a letter to the editor based on an earlier article Business Week did on deregulation or the prospect of re-regulation.

It is from Mr. James Theis. He is from Carmel, Indiana. He was responding to the proposal that there be regulation and he says he is a frequent flyer, a happy flyer, flies once a week, 40 weeks a year.

I think he reflects the typical business flyer who has been taking advantage of a lot of cheaper fares. He is basically fairly happy

He says:

> I am always amazed at how people who should have reasonable economic sense continue to call for the re-regulation of airlines when the net effect would hurt the vast majority of the population, especially the young and old who travel on reduced fares.
>
> If the airline industry ever does achieve a level of concentration that results in excessive air fares, then the American public can fix the problem relatively easily with new regulations. In the meantime, let's enjoy the great economic benefit of this industry competing.

The key words there are "in the meantime".

I am here to tell you that the "meantime" is going to be over pretty soon. It is not going to be the American public that is going to have to fix the problem by re-regulation.

It is going to be the Congress of the United States that will be faced with that dilemma.

Unless the smaller carriers are given an opportunity and encouragement and support to survive, you are going to be faced with that awful dilemma.

Let me talk for a few moments about the ongoing Federal initiatives that you addressed in the committee's notice with respect to this hearing and the things which you asked us to comment about.

Let me talk about, first the increased foreign investment issue.

The Department of Transportation's recently announced policy with respect to foreign investment in U.S. airlines does not really create new law. That was in the Northwest-KLM case.

What it does—and this step was welcome—is to create something of a safe harbor out of a number of confusing precedents. Let me give you two comments with respect to the Department's action.

First, there is nothing inherently wrong with persons who are not citizens of the United States providing capital for the maintenance and expansion of U.S. airlines and the U.S. jobs, particularly jobs created by U.S. companies that happen to be airlines.

The subsidy and national security concerns underlying the U.S. citizenship requirement in the current law are 30 to 40 years out of sync with the facts. The airline, shipping and telecommunications industries are the only remaining U.S. industries with significant barriers to foreign investment, and the similar citizenship definitions in the shipping and telecommunications industries are applied in such a way as to permit meaningful foreign investment.

Capital is capital, without regard to its source. Capital creates and preserves jobs. Capital creates airline competition. To the extent that the U.S. airline industry remains an attractive, long-term investment for persons outside the U.S., everything possible should be done to encourage such investment.

We have already seen major benefits from foreign investment in America West, Northwest and Continental. In our view, the Congress ought to support the DOT's recent policy statement and move promptly to expand such opportunities. Specifically, the Congress should reduce the requirement of U.S. citizen ownership of voting securities from 75 percent to 55 percent or 51 percent.

Alternatively, the Congress should give the DOT Secretary discretionary power to exempt transactions involving foreign investment up to the 45 percent or 49 percent level where certain public interest goals are met. These policy goals would be the preservation of U.S. airline jobs, the necessary strengthening of U.S. carrier competition, and the promotion of a more balanced U.S. airline industry.

This is probably the single-most effective step the Congress could take to the public policy goals of the Aviation Act.

Our critical need is for new capital infusions and we must search beyond our U.S. geographic boundaries to find additional investors.

I talked in my testimony about cabotage, fuel cost interventions, the release of fuel from the SPR. I talked about CRS regulation.

Mr. Chairman, you assured me my golden words have been read so I won't repeat them for you this afternoon.

I did want to mention here, though, what we had to say about the sale of international routes. The Department of Transportation presently approaches route sales and transfers on a case-by-case basis.

The inquiry in each case is the same. Will the sale and transfer promote competition by maintaining the viability of the selling airline while maintaining effective U.S. flag competition on the route? Pan Am obviously endorses this policy.

The suggestion that there is something wrong, per se, with selling international route authority ignores several crucial facts. First, usually the selling airline has invested heavily over many years developing that business and developing that route.

Secondly, you have to consider the alternative. In many cases, and certainly in the case of the recent Pan Am-United transaction, the alternative was greatly weakened U.S. flag competition on the routes in question and loss of competition over the rest of Pan Am's system. The transfers we have in mind will put strong flag competition on those routes while providing needed capital to enable Pan Am to reorganize and continue as a competitive force.

This is not to say that in every case the sale and transfer of a route must be approved. If the sale would not assist the selling carrier to remain an active competitive there might be legitimate concerns about trafficking in franchise rights. Under the Department's approach, however, such a liquidation type of transaction would likely be disapproved.

Let me skip to the conclusion.

In conclusion, we are faced with a crisis such as the airline industry has never faced before. The economic environment, with war, recession, fear of terrorism, excessive fuel prices, et cetera, is quite simply disastrous for the air transportation business.

The capital has been rapidly drained out of all but a few carriers. New capital, whether equity or loans, is not available from U.S. financial sources, either private or the government. Unless the Congress is prepared to consider a guaranteed loan program to support the weaker carriers, at least you must support and assist the limited measures I have addressed here today. Principally, the Congress must allow the continued sale of assets, including international route operations, and the Congress must expand our opportunity to attract foreign investment.

I appreciate the opportunity to express these views, and I would be glad to address any questions you might have.

Mr. OBERSTAR. Thank you, Mr. Mathias. We appreciate your views, and thank you for taking the time to be with us.

Overall, given the range of issues that the government can address, could have addressed, and some cases where they did not, to have alleviated the stress over the past year, certainly it seems to me the Administration has acted in a very limited and, in fact, timid manner.

What could have been done on the fuel price increases, it seems to me, from the moment that Kuwait was invaded, and I am not saying this with hindsight, because I was saying it at the time, is that the President could have directed the Attorney General to direct the full force of the government's antitrust authority into the speculative increases in price of crude oil in the absence of a market reason for that increase.

There was no shortage of oil at any time, and the prices went up. Secondly, all the White House would have needed to do, as was done in 1978 at the point of deregulation of the oil and gas industry, was to announce the reimposition of the windfall profits tax, and that would have taken the wind out of the sails of the profiteers and spared this airline industry these enormous, multi-billion-dollar losses that will not stop just because the price of crude oil has come down, and the price of jet fuel has stabilized.

You are going to be paying the price of that increase well into the future, I suspect. It is not going to end now. You are not going to be able to recoup in a week or a month or even six months the heavy losses already experienced.

That is one failure I see. The other is what I proposed to the Secretary, that the Administration suspend the 2-percent ticket tax increase for the duration of the Persian Gulf conflict and the duration of the recession. That is not a subsidy, as the Secretary suggested it might be. That is simply not imposing a burden that was not there to begin with, and which was not part of the understanding that this committee reached with OMB and with the Department in developing the Passenger Facility Charge. The PFC was needed for airport capacity enhancement, and we anticipated that the PFC would mean staving off the need for a ticket tax increase for several years. In any event we expected that that tax would go into the Aviation Trust Fund now or whenever in the distant future it would be needed.

So, those are two actions that haven't been taken, and I would urge this industry to pick up the beat on the ticket tax issue.

But to move further now, the slot-controlled airport buy-sell ruling, I thought, was bad when it was initiated. It has become worse, and I see some victims right here at this time of that rule at the slot-controlled airports.

There has to be a better way to do it. There was a suggestion this morning which has been—or this afternoon, rather, which has been made to have the public interest brought to bear on the sale of slots so that all those who want to serve this market have a fair shot at it.

Now, I would like to let the panel chew on that a little bit, and get your thoughts on this issue. This is a tough issue. The Secretary is going to be looking at this issue. He has to. We have been directing him to do it.

Mr. Beauvais, this is your chance to get something on the record.

Mr. **Beauvais**. We ourselves are very affected by the buy-sell rule on slots and feel very strongly that it does not act in the best interests of the industry, the traveling public, or most of the airlines in the industry. We do feel that by virtue of an airport becoming slot-controlled, that means that the demand for service goes beyond the ability of the industry to respond.

Therefore, those slots are very important resources that have to be allocated very carefully, so that the best interests of the traveling public and the entire industry are constantly at stake.

And we don't believe that an airline should be allowed to accumulate slots to its own monopoly interests under these conditions, which buy-sell permits. Therefore, we believe it is an antitrust issue, and we believe the antitrust laws that have been written adequately deal with that, and we believe that airports under a slot restraining condition should be subjected to that kind of approach, and there are easy solutions to allocate slots when addressing it in that perspective.

New entrants should be allowed in, and the slots that have to be yielded are those that are owned by the—or operated by the largest carriers there. No carrier should expect to build a monopoly at a slot-controlled airport. When those messages are sent early, the industry will respond immediately.

And it will not be a problem in this industry if those messages are sent in that way. But it is an issue that is directly related to the rights given by the Airline Deregulation Act, and that is for airlines in the inner market to compete. And when those barriers to entry exist, then there ought to be an antitrust approach in dealing with and resolving that particular issue.

I would like to say one more thing on your comment about immediate relief on the short-term problem. We wholeheartedly support your suggestion about the 2-percent ticket tax. But we would like to take that further.

In our opinion, that represents a very effective, immediate, viable plan that could be implemented. But I am talking about the entire 10 percent. If the industry is expected to collect 10 percent or the old 8 percent, you could do either one, we believe that those proceeds ought to be set aside at this time by the airlines who collect that money in the form of a loan from those carriers to the Federal Government in order to give immediate cash relief to the airline industry.

These loans will bear interest. Therefore, the government will make money on these loans. They can be cross-collateralized by every airline in the industry in the event one airline fails.

Therefore, the government is secure that money is well-spent. It is an investment in an industry that will promise a major payoff, and the government makes money on this.

Mr. **Oberstar**. That is a very interesting suggestion. We will be sure that the Secretary hears it, if his ears in this committee room have not begun to relay it to him. Others who wish to comment?

Mr. **Myers**. Mr. Chairman, I would just like to add to your comments on fuel. I think the Secretary today talked about the fuel problem as if it had passed. You heard Mr. Mathias say that we are still paying 50 percent more for fuel than we were prior to August 2nd.

That is also the case with the Hawaiian airlines, and that is also the case with the other carriers represented at the table. It is not too late to do something about fuel. I don't think we should simply act as if it has gone by.

Your comment was that it is going to take a long time to recoup what we have already lost. I think probably a more accurate statement is, we will never recoup what we already lost. Once it is gone, it is gone.

There is no way for people to get their fuel costs back once the fuel costs come back down; competition will take care of that. So, I think it is something that is gone. Anything that we can do in the future, now, to get fuel prices down where they belong, inasmuch as there is not a supply problem, I think we still would welcome that kind of activity.

Mr. **Oberstar**. I must say that the fuel price increase is part of a larger economic problem in the domestic U.S. I also serve on the Budget Committee and was astonished to review the budget document when it came to the Hill yesterday. I find nowhere in this document, that is a full four inches thick, nowhere is there reference to the word "recession."

In fact, an Administration witness before the committee called it a temporary interruption in the long-term economic growth of the Nation. That is the worst euphemism I have ever heard. They have got their head in the sand.

And the airline industry is a victim of that problem. Mr. Seiden?

Mr. **Seiden**. Mr. Chairman, two comments. One, as is not infrequently the case, you have again come up with an idea that I think deserves very serious and careful attention, a very creative idea, I must say, in suggesting that the airline industry ought to look to the ticket tax as a way of trying to solve some of our immediate, pressing problems.

I can assure you that we will take your suggestion to heart, Mr. Chairman, and look at that very carefully and very, very promptly. And also consider the expansion on your original idea that Mr. Beauvais threw out today. That also appears to have merit.

Those monies are essentially intended and earmarked to improve the infrastructure to pour concrete and to improve the various infrastructure systems that make our air transportation system work, but without many airlines to use them, it doesn't make all that much sense to build them.

And I think the first order of business, as I testified, is to take whatever steps need to be taken right now to stabilize this industry. And so, we will certainly look at those ideas immediately and carefully, and we hope that you will be available to talk with us about what we come up with.

One brief comment about buy-sell and slots. I am reminded, in thinking about the buy-sell system and talking about what people frequently say about democracy, which is that it may be the worst system of government known to man, except any other, and in thinking about the buy-sell rule for many years, the only thing that you can say about it in its defense, that you can be absolutely certain of, is that any other administrative system that you could imagine, and many of them have been tried, seem to work significantly worse.

And so, I think that we have to be very careful before we reject market systems that have been applied to the allocation of slots.

Mr. OBERSTAR. You say that with a straight face, even after Northwest lost the bid for slots at National?

Mr. SEIDEN. We are not finished with that, yet.

Mr. OBERSTAR. I wish you well, and all the other participants as well. I think the outcome there was proof of the unwise rule. But the problem is the rule is there. How do you unravel it? That is what I want to get your thinking on; how to do it better.

Mr. Vecci?

Mr. VECCI. Mr. Chairman, I just can't hold myself back from addressing this 10-percent tax that the carriers want to hold on to, and the bulk of that money would go to the very carriers who are buying routes all over the place, and buying slots all over the place, and I can't make heads or tails out of that type of proposal, and we are absolutely against it.

I have heard an awful lot about level playing field this morning, and it seems to become a slogan here, and I hope it is not repeated so often that you get to believe it. There is no level playing field. There won't be. Not only are the horses out of the barn, the barn has burned down.

The industry has, even the Secretary himself said the industry has boiled down to four to six carriers, and they will be competing in pairs. Pairs in Dallas, pairs in Minneapolis, pairs in Chicago, and Atlanta is not even a pair. We are chasing to find a competitor for Delta now into Atlanta. That is the type of industry we have, and we acknowledge it.

There is no level playing field. I just have to come back to my early remarks. We are always climbing up hill. We acknowledge that as a reality, but please do something about CRS fees. There is no service in the country where a vendor can send you a bill and say this is the price I am going to charge you, and you don't have anybody else to go to for this service.

The only businesses that can do that are regulated businesses. And something has to be done about CRS pricing. It is complete monopoly pricing. So, I ask you please to try to accelerate that process.

I just have one more comment.

Mr. OBERSTAR. Look at the bill I introduced on this subject last Congress, again this Congress, and see whether you concur that

that may be a good approach. Somebody in the industry—at least some—might be willing to support that approach. Because we do intend to move on that subject regardless of what the Department does.

Mr. VECCI. I will do that. And I just have one final comment, and that is on this foreign investment issue that has recently cropped up. We are not a big player in the international arena.

Nevertheless, this is one more area where the big carriers grow bigger through the ability to attract capital from foreign investors, and those investors aren't passive investors who think the U.S. airline industry is a nifty opportunity to get into for its own sake. These are airline foreign investors who are carving out a stake in the domestic industry.

They are going to wind up being our competitors. They are doing through the back door what they can't get through cabotage. That is what it amounts to, pure and simple. And we hear this is a device to help improve the competitive environment that we are in and the concentration problem that we are facing, and we hear other rationales that it is a result of all the debt that the carriers have built up.

The debt that has been built up is the result of management decisions. Pure and simple. It is not like fuel prices or some external events that are happening. So, this is another bailout that helps the big carriers get bigger. And here we are, we are climbing up here, and that hill is going to become a 90-degree wall we are going to have to scale, if we keep taking these actions piecemeal, one at a time.

Mr. OBERSTAR. Thank you.

Mr. Beauvais, you want to respond to that?

Mr. BEAUVAIS. Yes, Mr. Chairman.

On the issue of the excise tax, in my opinion, what we could do is to make it available to the carriers to the extent that they collect it. So, it automatically conforms to the size of the company.

For example, America West grosses about $100 million a month. We collect 10 million at the 10-percent rate. That would be the amount we are entitled to. American Airlines, much bigger airline, they can have it if they want it. They don't have problems raising money. Whether they elect to borrow it that way or some other way, that is their own judgment.

What I am saying is, it helps the industry. It also helps the strong as well as the others, but in my opinion, that is not bad. If it helps the industry, that is what we should be looking at. If it helps America reduce its losses in some form, that is fine, too.

But I think in this way, it can be an immediate relief for carriers who have significant cash requirements, and it can be done very effectively, and in a manner that can carry the industry through this time of crisis.

There is one other point that I would like to make relative to the CRS system. I got the distinct impression in listening to Secretary Skinner's remarks this morning that, let's be realistic about our industry. We are going global. And this industry has to deal in global terms.

And the U.S. carriers have to have all the weapons they can have at their disposal in order to be effective as a global competitor. And I think what he is saying is that American, armed with the Saber System, and United, armed with the Apollo System, will be most effective as they reach around the world and dominate the world's transportation system, and therefore, those particular objectives are consistent with the best interests of American business and the U.S. aviation industry.

I don't agree with that at all. I believe that we have a big enough industry in the United States in order to resolve our issues as we develop a very effective competitive environment in the U.S. And what works good here in the U.S. will work throughout the world.

Therefore, if we need to address the shortcomings of what the CRS system does to our Nation's airline industry, we ought to. And we ought to solve that. We ought to allow the smaller-sized companies to effectively compete. They ought to be given equal access to the market that the CRS system denies.

Now, that may diminish slightly America's ability to compete on a worldwide basis. However, the offset to that is a major reaction that we are experiencing around the world in terms of the fear of these carriers coming with these awesome weapons.

And as a result, these obstacles will be real. The negotiated bilateral agreements will be part of addressing what other countries feel are threats to them. And the ability of U.S. carriers to successfully compete on a worldwide basis will be there whether the U.S. carriers own a CRS system or not.

These can be independent technology companies. They can be divested from the carrier owners. And as a result of doing well in a U.S. domestic market that represents 60 percent of the world market, the airlines in the U.S. don't have to look worldwide with any disadvantage for not owning their own CRS system.

So, I don't think we handicap the U.S. carriers by, for example, forcing divestiture of the CRS system. I think we improve the U.S. airline industry's position as it prepares to compete on a global basis, because we will have more airlines in the U.S., more successful competitors in the U.S., and more ability of U.S. carriers to grow in global market because of this success.

Let me give you an example: The automobile industry in the U.S. There are three. Big market, but there are just three. And we often hear about the competition that we get from Japan. Well, there are 11 automobile manufacturers in Japan, and that is a much smaller market.

But it is a much-feared market, because those manufacturers are very efficient and very effective in producing their product. They don't need just three there. And that is a smaller market. And yet, those competitors are very effective.

And in my opinion, the U.S. airline industry is so large now and so important in the U.S. as the only mass transportation system that we have, that it should be a breeding ground for very effective airline companies, not just four or five, it should be at least as many as we had when we deregulated, and that was 24.

And so, we should have a lot of the airlines in this industry that are very tough, that are very efficient, that are highly competitive and are very eager to take their product throughout the world.

And the CRS system stymies the whole process. It is an absolute monopoly that is forming that stymies the ability for this industry to be healthy and efficient domestically, and for this industry to grow as effectively throughout the world, as it can.

Mr. **Oberstar**. We will welcome your enthusiasm on that subject when we revisit it.

Mr. Mathias?

Mr. **Mathias**. I just want to say amen, and two quick remarks.

Mr. **Oberstar**. Amen with respect to CRS? I think it was Pan Am that stimulated this committee's interest some years ago to the overwhelming power of the CRS system in Japan, that squeezed out U.S. carriers.

Mr. **Mathias**. That is right, and it has had a worse impact in the United States. And we have been a have-not, and we have been subject to extortion for many years now, and it is millions of dollars a year from each of us at this table who are going to make American and United great.

On the issue of foreign investment and cabotage, which Mr. Vecci made reference to, I just to emphasize for you that we really see them as opposite. Cabotage really means that foreign carriers are going to fly in the United States and we are going to lose pilot jobs and other jobs to foreign carriers flying in domestic markets. In the long, long term, maybe not bad, when we are able to get global entry and do the same thing overseas, even though no foreign country is even considering it, as we are. In fact, we were forced out of Germany when Berlin became part of Germany, and cabotage was verboten.

But foreign ownership, foreign investment that we are talking about, not necessarily foreign control, enables us to keep those jobs at Pan Am and other carriers. They are looking for capital for us as management and pilots and as maintenance workers and people at the gates; to operate Pan Am as a U.S. airline within the United States and provide competition for the big three and the big four, the big five.

So, there is a difference there that is fundamental between cabotage and foreign capital infusions. And, the last remark I had, very quickly, was, don't be sold by the sweet statements that you hear, not only from DOT and others that the fuel price problem has gone away; that prices have "stabilized." They have stabilized at 50 percent above what they were in July at Pan Am.

Our price has gone in the area of 60 cents a gallon to—it is still over 90 cents a gallon, particularly at places overseas. So that problem has not gone away by any means, and it is going to be devastating to our cash flow.

We pay, as all airlines do, cash, U.S. dollar, on the barrel head when you buy the fuel, and it is just sucking the cash out of every U.S. airline.

Thank you, sir.

Mr. **Oberstar**. Well, thank you.

I will call on other colleagues now, but Mr. Skinner's comments this morning reminded me of both his observations on the economy and the future quick recovery of the airline industry, of an observation Walter Heller made when he was Chairman of the Council of Economic Advisors. He called that kind of thing incantation economics, praying for but not doing much about recovery.

Mr. Hobson—Ms. Horn?

Ms. HORN. Yes.

Gentlemen, thank you very much for all your comments. It is interesting hearing the five of you representing airlines that are very similar in many ways, and yet having some very different views. I am struck by the fact that you seem to agree perhaps on only two possible remedies to the current financial condition of the industry.

One might be to control fuel costs, and the other is to regulate CRS, and certainly this seems to give us something to aim at. We all agree these are very traumatic times; Mr. Oberstar, the subcommittee and myself will work to ease them.

I think, just to mention a couple of canards here, we all agree there is no free market in your business, and secondly, the law of unattendant consequences seems to come back to haunt us later, leaving us leery of attempting sweeping solutions to problems that vary so differently, depending on the different circumstances of the various airlines.

For example, in my own district, we have TWA, a private airline owned by a person who, by his own statements, does not really care to be in the airline business. Although high fuel costs and CRS-aided gouging have played a small role in this once-strong airline's decline, it is TWA's massive debt load and Mr. Icahn's refusal to reinvest in the airline that have wrought TWA's fall. Legislation limiting price-gouging by oil companies or CRS owners would provide short-term help, but would not solve the deeper problems affecting this industry. These problems will require close scrutiny and a careful weighing of options before we pass legislation reregulating any part of the airline industry.

I am delighted to be on this subcommittee, very delighted to have the opportunity to visit with all of you, and look forward to working with you very carefully to try to address these very, very real problems facing this industry, and I thank you for being here today.

Mr. OBERSTAR. Let me return momentarily to another subject, and that is the international route sales. There is a spectrum of difference of viewpoints on that subject. Why does the Department go to all the trouble of selecting through this long process the best qualified carrier to serve a particular route from the standpoint of the public interest, if the carrier then turns around and leases that route in turn to the highest bidder?

Now, there are some routes where the carriers have indeed held the route for many years, developed that route, developed a value to it. And some argument can be made there that, you know, that route could be sold, and the profit returned to the seller.

But in the 19th century, we wanted to develop the West, so we gave the railroads alternate sections all the way across the route they wanted to develop, let them go forth and develop it.

There was some public interest involved there. We gave these routes to carriers, free of charge. Nobody had to pay for them in the first place. They were public domain. It seems to me they ought to remain in the public domain, in that the subsequent disposition of that route inured to the public benefit.

I am not persuaded on the history of sales that the selling carrier has been lifted out of economic difficulty. Eastern's routes, gates, slots, have been sold until there was just a shadow of the airline left. And the same could be said of other carriers even represented at the table.

So, how do you deal with this matter? What policy do you recommend, you practitioners of the art and the science, that these policies can be reconciled, and what is the best way to manage such a policy in the future?

Mr. Mathias?

Mr. **Mathias**. I addressed that partly in my written statement and my oral statement. I won't repeat those, except that I agree with you on the distinction you draw between routes that have been held and operated and have been the franchise under which or over which a carrier has invested its own resources and built a business and transferred it; as opposed to a route that has been awarded, and then three or four or six months later, perhaps in some cases without ever really being started, it becomes an object of potential sale.

That is clearly trafficking licenses, and it ought to be required, and I really think DOT has sent a signal in one or two of those cases that it would not receive a welcome response from DOT.

The other is a liquidation case, where even if you have invested over the years and it is now just a matter of selling them off to the highest bidder, that is a case where the government ought to say, we are not using the resources of the sale to strengthen a weak competitor and keep them alive and going in part of the industry, we are just really kind of selling these off at an auction.

And that applies to slots, too. Right now, there is this slot auction that went on yesterday in New York, I think is a dramatic example of where a carrier that is a new entrant that needs slots at LaGuardia and National, and Pan Am would like some. We don't have money to deal with some of those people.

We feel some of those slots ought to be taken back by the government and allocated on a public interest basis.

Mr. **Oberstar**. Wouldn't it be of greater value for Pan Am, to take your own case, to have increased access to those airports where you can compete rather than put Pan Am in the position of having to sell some other asset that further reduces its competitive abilities?

Mr. **Mathias**. We went to the auction and we can, as an expression of our interest, lay the groundwork to request for you and the government to help us, and we bid for the slots we felt we could use profitably to operate services from LaGuardia and National.

We bid what we have, which is $10,000. Other people were bidding 100, 200, 300 per slot. Obviously, we didn't win the auction, but maybe with your help, we can make up the difference.

Mr. **Oberstar**. Do you know, Mr. Mathias, whether any carrier has asked DOT to reclaim some of those slots?

Mr. **Mathias**. I think as of right now, I am not sure, but it will be very soon. We have been busy with other things this morning, but I think that DOT has already indicated they are going to have to review the results of this auction to make sure it is consistent with public interest standards.

We certainly are going to encourage them to do that in a proactive manner as opposed to just rubber-stamping the results of the highest bids.

Mr. **Oberstar**. Mr. Seiden?

Mr. **Seiden**. Mr. Chairman, I would like to comment briefly on the international route and sale issue that you asked us to address. It seems to us that there are two issues that the DOT, I think, properly takes into account in looking at these international route sales, and we at Northwest, at least, think we have got it about right.

From the perspective of the seller, the public interest issue that the DOT focuses on most closely is, will the sale of this particular route viewed as an asset give the seller a reasonably good prospect for survival?

There are no guarantees in this life, obviously, but the DOT does look at that, and they look at it very closely. And from our perspective, if a route sale does provide a reasonably good chance for one of our precious few airlines that are remaining to survive, then by all means, that route sale ought to be allowed from the perspective of the seller.

From the perspective of the buyer, the DOT has long viewed the necessary result as one that preserves the essential public benefits that the DOT identified in allocating the route in the first place. At least that amount and hopefully more.

So that if the buyer cannot demonstrate that it will operate the route in essentially the way that was intended when the route was allocated, and perhaps even improve upon the service the seller will be offering, then the route sale won't be allowed.

And I think that is probably the best way of looking at it in terms of protecting the traveling public. It is clear to me that if the DOT concludes that either one of those, that is, preserving—reasonably preserving the prospects of the seller to survive, and certainly preserving the benefits to the traveling public, if either one of those cannot reasonably be predicted to occur, I think the DOT won't allow that route sale.

I think the issue should be less one of how long you have operated it than one of whether those two factors will be advanced.

And I think if they are, then the sale should be allowed.

Mr. **Oberstar**. Mr. Beauvais?

Mr. **Beauvais**. In our opinion, at America West, you are applying some deregulation theories to a regulated market. International routes are regulated. They are regulated by treaty. They are valuable because the Department of Transportation at one time said they were to the company that won the route.

In our opinion, they should be valuable for that airline as long as they operate pursuant to the authority granted by the DOT. The only time they assume value is if the government says yes, you can sell them. Then they have got value. Then Wall Street gets on it, the bankers get involved, and the companies say in the assessment of the value of more money, those routes are worth money because the DOT approved the sale.

So, the government's actions place the value on those routes. In our opinion, those carriers paid nothing for those routes. They earned the right to operate those routes. Those routes are valuable as long as they operate them.

But the DOT should select thoroughly each international route transaction to determine if that is consistent with the national interest and the interests of the U.S. airline industry when making decisions about international route transfers and whether money is involved or not, that is another factor.

And of course, it can be, because in that investigation, if the government wants to make money, if the DOT feels that that is in the best interest, they can then make that part of it, and then have some kind of a profit-sharing arrangement made with the airline that buys the route as a result of this investigation, so that some of the benefits associated with that transaction flow back to the Department of Transportation.

But if they want to make it an economic game, they can. But in our judgment, those routes only have value if the DOT says yes, you can buy and sell those routes just like you do slots.

Mr. OBERSTAR. Thank you.

Mr. Clinger?

Mr. CLINGER. Thank you very much, Mr. Chairman.

Gentlemen, I apologize for not having been here to hear all of your testimony, so my questions will be related to your written testimony, if I may, and if you have answered these before, why, just indicate.

Mr. Myers, you suggest that the United States should seek cabotage rights in foreign countries as part of a liberalization of the bilateral aviation agreements that we have developed over the years.

Would you be willing as part of that to concede cabotage rights for foreign carriers in this country in return, and wouldn't we be giving up more than we get in such an exchange? We are, after all, the largest aviation market in the world, and everybody wants a piece of our action.

Wouldn't we be really giving up more than we get?

Mr. MYERS. I think the rest of my testimony would suggest that we look at these things on a case-by-case basis. There was an instance, I think, this morning where someone talked about Malaysian Airlines, why would we want to go to Malaysia, not to pick on Malaysia.

But it would depend on which country we are talking about, and I think that is very important when considering foreign investment; we need to look at this on a country-by-country basis.

If we have got routes into Japan in exchange for the Japanese getting routes into the United States, you could make the trade-off in terms of economic benefit, you could make a determination whether it is a smart thing to do or not.

You could make the same kind of determination for Malaysia.

So, I think that is the key. It has to be on a country-by-country basis.

Mr. CLINGER. KLM would offer us landing rights anywhere in Holland in return for landing rights anywhere in the United States? Hardly a fair exchange. As we have heard discussed this morning, currently, under U.S. law, foreign ownership, at least with voting rights in U.S. airlines, is limited to 25 percent, and I gather you have all discussed this issue, but what is so magic about 25 percent?

Why not 33, 39, or even indeed 49 percent? What is the rationale? Do you have a concept of what the rationale is for limiting foreign ownership to 25 percent?

Mr. Myers. The 25 percent, of course, is current law. Buried in 50 years now of law and precedent. So, I am not so sure there is any excellent rationale for the 25 percent. In my written testimony, we suggest there is no reason why that shouldn't be increased as long as we are careful about the way we do it, and again, it is done on a country-by-country basis.

There is a lot of sentiment in that regard in the airline industry. I think most people say yes, it is okay, if we increased the percentage number, but we need to be very careful about how we do it, and again, which countries we deal with.

Mr. Clinger. I introduced a bill yesterday that I would be interested in getting anybody's views on, which would basically permit an increase of foreign ownership to 49 percent, but requires the Secretary to find that the purchase would meet a number of strict conditions; specifically that the investing individual be from a country that has a pro-competitive agreement with the United States; that the foreign individual seeking investment in a U.S. airline comes from a country whose laws would permit a U.S. national to purchase an equal percentage in their airlines, and also considerations having to do with national security and the public interest.

It seems to me if we start down this path, and I think there is a real need as the Secretary said this morning, that in the next 20 to 25 years we are going to see a globalization in a lot of industries, including aviation. So the question is, do we get ahead of the curve or are we going to be coming along behind?

And I would hope that we might get in front of the curve and be a leader in this area.

Mr. Myers. We had a real live example we dealt with in Hawaii where certainly we had a U.S. citizen owning voting control, but this individual had all the money to buy that 75 percent from foreign sources.

So perhaps we should be looking at a total debt and equity limit, and we proposed a larger number in our testimony, but we need to be very careful with where that money comes from to buy the voting control.

Mr. Clinger. Good point.

Mr. Mathias?

Mr. Mathias. I just want to say that sight unseen, I think this is a terrific bill.

Mr. Clinger. I appreciate the support.

Anybody who doesn't think it is such a terrific bill and why not?

Mr. Vecci. A resounding silence here. I can't resist commenting. It seems to us that this need for foreign equity really flows from the fact that carriers have a large debt load. That comes about because of buying airplanes.

True, we are in a problem economy today where short term, there is needed capital. But talking about a need for equity that comes from foreign sources as being the answer to bolstering up carriers, and with that foreign source winding up being a foreign airline and getting a foothold in this country, is hard to make sense out of from the standpoint of an Alaska Airlines. We just can't see the reasoning here in opening that door and allowing foreign carrier access to the U.S. domestic market.

I know Pan Am here takes issue with the word cabotage, but whether it is cabotage in its strictest sense, it is a foreign airline investing in a U.S. airline, not as a passive investment, but in order to accrue marketing benefits throughout our country. So we oppose that.

Mr. CLINGER. Okay. Just one final question. Obviously one of the reasons for the problems that you are all having has to do with the spiking up of fuel prices which has gone on for sometime, but they now seem to be receding somewhat and have been for the last two or three weeks.

My question is whether that reduction is being passed on to you. Are you seeing that in your purchasing that you have to do now, or are you not yet benefiting from reductions in price?

Mr. BEAUVAIS. There has been quite a discussion this afternoon on that issue. Our fuel costs are still 50 percent above where they were prior to August 2nd, so any interpretation of that as stabilizing disturbs us. It is a very serious problem for us, and it is still a problem when you combine it with the recession and the security problem with people electing not to travel because of the war; it gives the industry an inability to recover even that. And so there is a very serious economic problem today and the cost of fuel very much out of line with what it was prior to August 2nd.

Mr. CLINGER. You raise another question which has to do with the confidence of the traveling public in the whole system, and I know that I was at a briefing the other day where Secretary Skinner talked about how he has been trying to restore that confidence, talking about the airline industry as being very safe, safer than highways and so forth.

Do you feel the Department of Transportation is doing enough at this point in reinstilling in the traveling public, business public, tourism and so forth, that there is a threat but it is a manageable one and it is one that people should be overly concerned about?

Mr. Mathias?

Mr. MATHIAS. I think all the carriers have at least one shared comment on that, in that while the Secretary's instincts are to support the U.S. carriers, he has not taken yet—one specific, we have been urging him as a group to do for the past two years, and that is to signal his concern by applying to the foreign air carriers flying to and from the United States the same security protection requirements that the U.S. carriers are providing for travel by U.S. citizens.

There is no question that we are not trying to make things more difficult than necessary for foreign flag competitors. What we are trying to do is make sure that, A, U.S. citizens flying to and from New York or other U.S. cities overseas have the same protection whether they fly on U.S. or foreign flag carriers; and secondly, to avoid a situation that we have now, where the disparity between the two systems sends an implicit signal to the travelers it must be safer to fly on foreign flag carriers because they are not required to have the same security. In fact, the opposite is true.

Mr. CLINGER. I was going to say that it cuts the other way, too, that people feel more confident on an airline that has more stringent security requirements.

Mr. **Mathias**. We have found it more the other way, that while we think we are providing a safer product, the fact that we make it thereby inherently more inconvenient, and the security is more of a heightened and visible aspect of our service, more customers feel that, especially the frequent fliers, that while, look, apparently with U.S. Government sanctions it is safer to fly, and certainly more convenient to fly on a foreign flag carrier.

You take that one step, it is not so much a level playing field, but applied to security and safety protections to all carriers flying out of U.S. airports. That is what we have been asking for, and so far we have not gotten a response that is positive.

Mr. **Clinger**. Thank you, Ms. Chairman.

Ms. **Horn**. Mr. Kolter?

Mr. **Kolter**. It is rather difficult to continue after a lapse of several hours because I am not sure what was asked during the period of interrogation. But I do have a concern that may or may not have been asked of you as a panel. My concern is, how do you as a panel feel about the reallocation of the Eastern slots?

Should that be by lottery, should it be by the active airlines paying for these slots, and if so, would it not be a definite advantage for the wealthy carriers, or is there no such thing as a wealthy carrier?

Mr. **Beauvais**. Yes, Congressman. We have been an airline that has long sought to obtain slots and to improve our service levels at the slot-controlled airport. And to have a bankruptcy judge now control where those slots go seems to us to be moving in the opposite direction, away from the DOT and the FAA's responsibility and into another legal realm that is relatively new to our industry, but may be around for a while.

And so in our opinion, to respond to your question, we are very disturbed at what is happening with respect to the Eastern slots. There was an obligation on Eastern's behalf to operate those slots. Eastern was unable to.

In our opinion, those slots ought to go back to the DOT and the FAA, and be allocated to industry carriers who have an interest and will be allocated in a manner that is in the best interests of the airline industry. That is our opinion.

We just don't believe the buy-sell rule and the bankruptcy laws are an effective remedy for the slot issue that we now confront as far as Eastern is concerned.

Mr. **Kolter**. I think you will find many of us on your side, but we don't know how to correct this total injustice.

Thank you very kindly.

Mr. **Beauvais**. The Department of Transportation could just reject the selling of slots, and they could then assume total responsibility over those slots.

Mr. **Kolter**. So it looks like you and I have a problem. We must lobby the DOT and Secretary Skinner, evidently.

Thank you.

Ms. **Horn**. Does the gentleman from Tennessee have any questions, Mr. Duncan?

Mr. **Duncan**. Yes, ma'am.

I will be very brief because we have got other witnesses to get to, but earlier today I asked Secretary Skinner about the ease of entry or lack thereof into this industry, and I just wondered, some people have predicted that in a few years, and not too many years, we may see just two or three or four major airlines.

Do any of you on the panel foresee more airlines in the future, or do all of you agree that there will continue to be a decrease in the number of airlines and a further consolidation of the industry?

Mr. **Vecci**. I don't see any more. You can count on that.

Mr. **Beauvais**. America West is a product of deregulation, so we are believers in deregulation. I do see more airlines if the issues that are important to our industry are dealt with effectively.

If there is a divestiture of the CRS system, if there is a breakdown of the barrier to entry in slot-controlled airports, and if the industry can be assisted right now in a major depression that it is experiencing as a result of the energy crisis and the security problems that the industry is facing, if we can have an industry that is effective in terms of its competitive environment, where carriers, regardless of size, can look forward to an opportunity to be successful, then we will not have a problem raising capital, and capital will be there for prospective new entrants. But these issues must be addressed.

And if the further concentration of the industry continues, then you are not going to have more new airlines.

Mr. **Duncan**. I asked Secretary Skinner this earlier this morning, and I think that the deregulation has basically been a pretty good thing contrary to the opinion of many on this committee.

But what would be the effect on some of your airlines if we suddenly came in and re-regulated the industry to a very great degree? Do you think it would have much effect on any of your companies?

Mr. **Myers**. I would agree with Secretary Skinner's answer. I think that the prices would go up, and that it certainly would not be a competitive thing to do. I think his answer was correct.

However, I certainly agree with Mr. Beauvais in that there are many things that can still be done to make this industry more competitive and to assure that small carriers will still be around and you are not going to end up with just three or four.

One of the things we brought up in our testimony has to do with new international routes. International routes are some of the most profitable opportunities that are available to us in the U.S. airline industry. One of the problems that we currently have is that those routes seem to always go to the big carriers. It is difficult for a small carrier to break into a major international route.

One of the problems we recently had was that we simply could not get into the Honolulu-Tokyo market, in a recent case, because we didn't own 747 aircraft. That is a ridiculous criterion to determine who should get the route. It is very simple to get the aircraft once you have the route. The route can in effect become collateral for the purchase of those aircraft.

But I think that is one example which would have helped assure that Aloha Airlines would continue to exist; it would have doubled the size of our carrier overnight, put us into a market where we have been active for over five years; but because we didn't have the aircraft, we were not allowed to get that route. That was determined to be the primary reason that Aloha was not considered for that route.

Mr. **Duncan**. Again, I mentioned this this morning, but some people seemed to imply by their questions that this is an industry now in which there is almost no governmental regulation whatsoever, but yet looking at it from a distance, it seems to me this is a very highly regulated industry.

I wonder if any of you think that there could be further efforts toward deregulation, and if so, what effect that would have on your industry. Would that help or would that hurt, or how do you feel about that, or have things been deregulated as far as they possibly can?

Mr. **Vecci**. A completely unregulated industry is what we have today. There are just a handful of carriers truly dominating the whole industry. It is a result of past approvals of mergers that created many of these huge hubs.

It is a virtual hands-off policy with the sale of facilities, the sale of international routes, and it is the carriers who have the greatest resources who are able to acquire the slots, the facilities, the international routes, and other carriers. That is the result of passive government policy, not only deregulation, but total passive public policy toward what the industry has been doing. And it is continuing today. The stronger are getting stronger.

And I keep coming back to this so-called level playing field. It is getting steeper and steeper to play on this field from the standpoint of carriers such as Alaska Airlines, and I think others at this table would share that view.

Mr. **Beauvais**. If I may add one point, there is a possibility of regulation that continues, and it is absolutely diabolical, and that is the Wright amendment at Dallas Love Field. That, of course, in our opinion should be repealed.

Mr. **Duncan**. One last question. Is it possible for a small company to come into this, is it harder today or easier today? If a wealthy individual or a group of individuals wanted to come in with one plane or five planes, could they do it today?

Mr. **Myers**. I think one of the sayings that we have learned in the airline industry over the last several years is that our business has made millionaires out of a lot of multi-millionaires. And it is very difficult for anybody to come along with a small amount of money and get into our business. The capital isn't available, and the Secretary said that this morning as well.

That is a problem, certainly. Our business simply hasn't had the kind of returns that attract bankers. Not from foreign investors who don't want to invest in start-up airlines right now. It is not a profitable industry. So it is more difficult.

So I think that is why. It is the fact that we are not a profitable industry these days.

Mr. **Duncan**. Thank you very much.

Mr. **Oberstar**. The gentleman from Mississippi, Mr. Parker.

Mr. **Parker**. Thank you, Mr. Chairman.

I know it is hard to get an overview when you are up to your navel in Allegheny. Were any of you here during the testimony this morning for my line of questioning? What I wanted to know was this. You are all CEOs, leaders in your companies. You could have a long-term view of things to some degree, even though historically as politicians and educators and business people, we have to look short term also. You do have a long-term view.

Now, let me explain to you that I look at our period right now as being a transition period. We are not at the end of deregulation; we are at a transition period. So all of the facts and figures that DOT comes up with and proponents sit up and tell me how wonderful it is about deregulation and how it has occurred up to this point, I am not a complete believer yet. The reason is because it hasn't played out completely. We are only talking eight to 10 years in this situation. Where we are going to find out is 10 and 20 years from this point. And that is where it is.

Mr. Beauvais, you are going to be in high cotton for another 15 years, if you still exist. The point is, are you going to be here? Now, you have every intention to be here. Your creditors believe you are going to be here, too, I am supposing.

But at the same time, that is the overall question I want to find out from you, what are your views as far as what is going to occur 10, 15 years, 20 years? How is our airline industry going to be structured? And are people going to be talking about the low rates we have to pay when we have three to five major carriers that basically have a monopoly because you can't get in, don't have the capital to get in? Is everybody going to be talking about how wonderful the situation is?

Mr. BEAUVAIS. I think the points you made this morning are very good. I believe that we were a concentrated industry when we were deregulated and I don't think the industry is better off having just four airlines.

We have had our chance to speak on this issue earlier this afternoon. We have an opportunity to change the direction of our industry today so that 10 years from now, people can be very satisfied with the direction and the service they get and the prices they are charged. But it has to be competitive.

We have to make this industry very competitive and we have to give smaller companies a chance to be successful. We have to deal with the barriers to entry that are there, that are monopolistic and as a result have to be recognized as such. The particular one that we are referring to, that I am referring to, is the computer reservation system. It stymies the ability to compete, and it really does contribute to the concentration problem that we have.

The other is, we have a right to go into an airport by virtue of the Airline Deregulation Act, and that right should rule over the monopolistic rights of those who own the slots at that airport at that time. They must be compelled to give those slots up for the best interests of our industry. If we have a highly competitive environment where many airlines can compete and depending upon their market niche can succeed, we will have a very healthy industry. But those changes must be made today.

We have talked about this for the last three, four years. The mergers that came before the Department of Transportation, most of them should have been rejected. TWA should not have been allowed to acquire Ozark; Northwest, Republic, and on down the line. Had that message been sent to the industry, we would have a different industry today. We would have a lot more competition at the hubs, and there would be a healthier environment in our industry.

We are saying at this time that that being passed, that now it is getting awful late. Here are some other issues that must be addressed to make this industry balanced in terms of the competitive atmosphere. And if we are truly competitive and the companies are truly efficient, can be successful, then the global trends in our industry will take of themselves. Because if we can compete with each other, believe me, we can compete with any airline in the world.

So there is not a real issue here of you have to do certain things in order to prepare American and United to compete worldwide.

The issue is the largest market is here in the U.S. You ought to make it effective. It ought to be competitive. It ought to be developing in the best interests of the consumer and those other issues will take of themselves, and 10 years from now we will have a great industry in terms of the traveling public in the U.S.

Mr. PARKER. But also understand that the American people have to understand what is going on, because, you see, we can turn around and the way things are going now there is this bill of goods being sold to the average person out there that everything is hunky-dory. We don't have to worry about it.

Believe me, we have got something to worry about because ten years from now we are going to pay the price, and I don't want to wait ten years from now and say, well, I told you. I would like to solve some of those problems now because if you have got a large carrier out there and he wants to get you, he will get you. He will figure out a way to do it. He won't put out a press release. You won't know, but he will get you, and he has the resources to do it.

There are three things that make a business work, and there are three things where you can get in the airline business and make it work, and you have got to have enough of it. They are cash flow, cash flow and cash flow. That is what you have got to have. Once you have that cash flow, you can do anything you want to if you are willing to put it out long enough.

The point is, I think we are in a very dangerous position. Now, you other gentlemen, I would like to know what you have to say about it.

Mr. MYERS. I guess I can give you a laundry list that I just put together that I think could be referred to from the viewpoint of a small carrier that would, I think, be very important in the next five, ten, 15 years in terms of what is required to ensure that we are still around.

Capacity is a problem. The Secretary talked about that. The system has to have capacity, and that is in terms of airports and ATC system. There is no doubt about that. The CRS, Mr. Beauvais has just talked about. We are totally a victim of CRS. We are in every CRS system that there is.

To give you an idea, we pay $2 every time somebody books into a CRS system. Our average fare is $35, so that gives you an idea of the percentage of the cost that we have to bear for CRS. Slots and gates is another area that has been talked about that I just added to my list. Access to international routes, we talked about earlier.

The small carriers are not getting international routes. The big carriers with the deep pockets are. One that hasn't been talked about is frequent flier programs. The frequent flier programs are an advantage to the larger carriers, because it requires flying on that carrier and loyalty to that carrier in order to add up the frequent flier points.

That is a great disadvantage to a small carrier or to a new carrier trying to enter a market. I think the last one that hadn't been talked about that is a problem for us comes in terms of airplane purchases. The manufacturers of planes sell planes on the basis of how many you buy.

As a small carrier, I pay between 20 and 25 percent more per airplane when I go out to buy airplanes. It is very difficult to compete with an airline that has bought airplanes at a 20 to 25 percent cheaper price than I have paid.

Mr. VECCI. That is very depressing when I ponder trying to answer your question, looking out five to ten years. I am not going to belabor CRS because I have repeated that story several times, and I am hopeful something will happen along those lines.

Among a variety of tools that the large carriers have, I think you summed it up with cash flow, cash flow, cash flow. When American or United grow by 10 to 20 percent a year, and by the way, it is American's stated goal until just recently given the economic downturn to grow between 10 and 20 percent a year. They create the equivalent of one to two Alaska airlines, just to put things in perspective, and we are a billion-dollar company. We have grown substantially over the course of deregulation.

When we compete with these carriers, we compete head to head with American, United, and Delta. We have nothing to offer, no structural advantage. All we can do is compete head to head in non-hub markets.

We can't even think of going to Chicago or Denver or Dallas or Atlanta. These areas are locked up by one or two carriers period; so we compete head to head on the basis of service and we also compete against CRS systems. We compete against incentive economic programs where the national, large national carrier has the cash and the resources to always outbid us in the travel agency community for business.

We compete against corporate discounting programs where the national carrier always has the ability to outbid us for corporate business. We compete for facilities in our marketplace against the carriers who already have long-term leases covering many gates. So when you ask what is it going to be like five to ten years out, unless there is some government action to restrain some of the huge structural advantage these carriers have, we don't know.

We are very reluctant to predict gloom and doom because we have been here for a while. We have had 18 years of consecutive profitability as Alaska Airlines. We have grown from a fleet of eight airplanes to 63 airplanes. Somehow we have overcome many of these obstacles, but the obstacles are getting bigger and bigger, and hopefully there will be some restraint put on them as you look toward the future yourselves.

Mr. SEIDEN. Mr. Parker, we at Northwest probably have somewhat of a unique perspective on these long-term issues that you so ably are exploring in these hearings. We are certainly not one of the big three. We are also not a carrier that is in right now severe distress compared to some of our colleagues.

We are not in bankruptcy. We have no expectation of being in bankruptcy. We are certainly looking to be one of the three to five, if there are going to be three to five carriers, major carriers that comprise the industry over the long-term, and I suppose that is what we think ultimately will happen.

We think ultimately there will be somewhere between three to five carriers. Secretary Skinner went as high as seven maybe. I think that is a little optimistic. I think what you are just seeing is the natural order of economic forces coming to bear on this industry, and what you are seeing is what we hope will be the final shake out.

Our intention is to be one of those four to five that survive, and we are looking for ways now to make sure that happens. We are trying to participate as aggressively as we can within the resources that we can bring to bear on the process to expand, to make strategic decisions that will ensure our long-term survival.

You see some of that being reported in the press. The transaction that we have announced with Hawaiian Airlines, for example, is designed to ensure our long-term viability in the Pacific. We have been aggressively pursuing a transaction at National Airport that would put Northwest for the first time as a major competitor up and down the East Coast.

We see a North/South presence on the East Coast as being critically important for Northwest's strategic position in its long-term survival, but it does appear that the industry is heading toward a structure where there will be three to five major carriers with national route systems basically being a full service, being able to deliver full service product and that there will be, we believe, a number of other carriers that are smaller that may be properly known as niche carriers of some sort. But we don't—it is hard to see now given the way things have been evolving in the last 6 to 18 months that we will see in ten years 18 or 20 or 30 carriers all with national route systems and all able to do all things to all people.

That is kind of what we see happening. For our part, we intend to do everything in our power to be one of the ones that are left standing after this fight is over.

Mr. PARKER. Yes.

Mr. MATHIAS. I wanted to add very briefly, Mr. Congressman, I really will be brief. Take us as one of the weaker carriers that has survived over many decades, but is now facing the worst possible, and take yourself as a passenger, and what you are seeing happening is a situation right now where the larger carriers with the advantages that they had when industry was deregulated and the advantages they have acquired since are dog eat dog eating us. But also it is the outside circumstances, the increase in fuel prices and other things, the war, the fear of terrorism are not the result of Delta or United or American or Northwest by any means.

When that process of concentration is complete, and it will be as everybody seems to agree, unless people like you and others step in and do something to give us a better opportunity to survive, then the next victim will be the traveling passenger, and that is the way it will work out.

Mr. **Parker**. It is interesting to hear all of you talk because you all come from the same perspective, and you view things the same way that I do in the long term. The interesting thing about it is that those that are talking about keeping everything as is in the course of deregulation are in many ways talking about limiting what carriers can do and how they can expand and how they can enter the market.

It is my contention that any segment of the marketplace, whatever segment you are talking about, if you limit an individual's ability to be able to put capital together and go into that marketplace and compete, if you limit him, then you have hurt the entire marketplace. And that is what bothers me.

We are going to get into a monopoly-type situation, and the American people do not understand the significance of it yet. They will not understand it until later, and I think we have got to do something to open it up so that the smaller carriers can have a piece of the action, and ultimately we will have more competition if we do that.

Thank you very much. I am sorry, Mr. Chairman.

Mr. **Oberstar**. That makes up for the time you missed this morning.

I have a brief question because we do have two other panels I want to get to, and that is on the matter of ownership and the distinction of ownership or within the ownership rubric of control and how it is measured and the distinction between equity and debt in that context.

Mr. Myers, you suggested that there could be percentage limit higher than perhaps now envisioned on total debt and equity invested in a U.S. carrier, quoting from your prepared statement, and that there would be some limits on that; for example, only in cases where the foreign investment derives from countries which have reciprocal U.S. rights.

I am for reciprocity. I strongly have advocated such. What is the breakpoint in control? You know, the Securities and Exchange Act, not interpretations of that Act, but the Act, itself, back in 1934 and subsequently amended, required reporting to the SEC within ten days of the time in which any shareholder acquires more than 5 percent of the company's stock.

Well, if you have no shareholder and no equity interest, no debt interest person who has more than one or two percent, and somebody gets 49 percent, who has control?

Mr. **Myers**. I guess first we should admit that we are not smart enough to set the limit, and the 70 percent limit that we suggested was suggested because, as we mentioned earlier, of a real life situation that we got involved in where a U.S. citizen nominally owned 75 percent of Discover Airways.

However, the fund to purchase the 75 percent had been borrowed from Japanese sources. There was, by our estimation, about $150 invested of real U.S. money. What we are getting at, then, is I think it is important to consider not only the equity, but the debt in total to determine control. We are saying that could perhaps be as high as 70 percent when you combine it all and could still be considered not to be control. So that was what we were getting at.

I think that you can't simply look at equity. You can't simply look at voting control, voting equity. You have to really look at the debt and equity to determine whether control exists, and in our particular case we finally got to the truth.

Mr. OBERSTAR. Comments by any others?

Mr. Mathias?

Mr. MATHIAS. Well, Mr. Congressman or Mr. Chairman, it is obviously a question that we could debate, you know, for many hours as to what circumstances you would consider to be across the line of control, effective control or not. But it seems to me that you can, with some assurance, feel comfortable so long as a minority of the voting equity, even if the rest of it is dispersed, only a minority is in foreign hands, and that the majority of the board of directors and the majority of the senior offices or at least the President and the most senior officers are mostly U.S. citizens, and those people, as has historically been found do, in fact, control the airline or any other corporation.

Mr. OBERSTAR. Well, there is a very fine distinction you draw about who has voting rights and who holds shares with voting rights, and then the equity and the debt question, and the way I look at it, I sit down and I have only got 5 percent of whatever, and someone else has got 49 percent, sooner or later I am going to be outvoted. I am going to be out-decisioned. I am going to be out-maneuvered. When it comes to airlines, when those who are most interested outside the United States in investing in airlines are other airlines which are owned principally by their governments, and we can go down the list. We had a list prepared of all the European carriers and the Pacific rim carriers.

There is only one that is below 50 percent government-owned except for JAL, you know, and Korean Airlines have been privatized. Is it a good policy for foreign governments to be investing in U.S. carriers when they haven't changed their rules? Reciprocity is what I am looking for in the broad policy.

I am willing to see our regime changed, but within the context that we have always negotiated, rights for rights and values for values, you open up your market to the extent we open up ours, and let us come in and compete, or we are going to see airlines go the way of the VCR's. We invented them. We are now buying them from the Japanese.

We invent the color TV. We are now buying them from the Japanese. We invented the semiconductor, and the Japanese cornered the market on it. I just think that whatever we do ought to be done with full understanding of the long-range consequences of those decisions. I did my graduate studies in Europe and the College of Europe, in a European studies program prior to the signing of the Common Market Treaty, I have followed those matters very, very closely.

Classmates of mine are high-ranking in their own governments or in European international institutions, and I follow those developments on a weekly basis. I know what they are doing, I know where they are heading and in some cases they don't know where they are headed, so I just argue for a more cautious approach that assures equity, fairness, equality of opportunity, end of sermon.

Mr. Myers?

Mr. **Myers**. Well, I liked your sermon, Mr. Chairman, and certainly agree with the concept of reciprocity, and I think it is absolutely necessary to move forward on this issue. I think maybe I can bring one more real life scenario that could help with this, and that is in Hawaii most of the major hotels are now owned by foreign interests, and primarily Japanese.

What has happened over the last year, as we all know, in Japan is that interest rates have gone up substantially, in the range of 50 percent. They have gone up in some cases from 4 percent to 6 percent.

Anyway, they have gone up a lot. This means that the debt service on the debt that is used to buy those hotels has gone up substantially. At the same time what we have seen, then, is that operating expenses for those hotel rooms have gone up substantially; so what we have ended up with is that prices for hotels in Hawaii, because they have to cover service debt, are being determined not in the United States and not in a free market, but by foreign interests. I think that that kind of an example could come home to haunt the airline industry as well.

Mr. **Oberstar**. Thank you. Mr. Seiden?

Mr. **Seiden**. Yes, Mr. Chairman, I would like to provide just one more piece of information that I think you would probably find useful to round out the record. It sort of punctuates something that Secretary Skinner said this morning discussing his decision to approve Northwest's petition on the KLM ownership issue.

We did some research before we came here to find out what the Dutch rules are on investment as opposed to the bilateral regime, and to the best of our knowledge, the Dutch law on investment in a Dutch airline is a foreigner may own up to 49 percent of a Dutch airline and there are no other additional restrictions of any kind applicable to control. So if any of these gentlemen here sitting with me want to buy 49 percent of a Dutch airline, why, the road is clear.

Mr. **Oberstar**. I referred to that earlier, the Secretary did. For in this case it just happens to be that the Dutch have a very liberal regime. I talked quite some time ago with a leading Dutch official about aviation trade between the United States and the Netherlands, and he concluded his statement, by saing that, in exchange, the Dutch would let American carriers land anywhere in the Netherlands.

I said that is a good deal. The whole country is less in size than my congressional district. To conclude, if foreign shareholders had 49 percent of an airline and no U.S. shareholder had more than 1 percent, how responsive do you think that 1 percent shareholder would be to the foreign interest even though that foreign interest didn't have total control?

Thank you, gentlemen. Your thoughts have been very, very productive. I have appreciated the two hours we have spent together; it was very useful. We have journeyed a long way. We have many more journeys to make in this business. We all have the common interest of keeping the U.S. airlines competitive, alive, healthy. We are trying to do our best to achieve that goal.

[The prepared statement of Mr. Myers appears on p. 334.]

[The prepared statement of Mr. Beauvais appears on p. 164.]

[The prepared statement of Mr. Vecci appears on p. 374.]

[The prepared statement of Mr. Seiden appears on p. 352.]

[The prepared statement of Mr. Mathias appears on p. 312.]

Mr. **Oberstar**. Our next panel consists of Randy Babbitt, the President of the Airline Pilots Association, and Mr. William L. Scheri.

Gentlemen, welcome. We are glad to have you again before the committee. We look forward to your presentation, as is the standard practice of the committee. Your prepared, complete text will be included in the record and you may summarize as you wish.

TESTIMONY OF RANDY BABBITT, PRESIDENT, AIRLINE PILOTS ASSOCIATION, ACCOMPANIED BY R. RUSSELL BAILEY, ATTORNEY, ALPA, AND WILLIAM L. SCHERI, V.P. TRANSPORTATION, INTERNATIONAL ASSOCIATION OF MACHINISTS, ACCOMPANIED BY ROBERT CLAYMAN, GREARY, EDMUND AND JAMES

Mr. **Babbitt**. Thank you, Mr. Chairman, Members, good afternoon.

I am Randolph Babbitt. I am President of the Airline Pilots Association, and I represent over 51 airlines and 42,000 members in my union. We appreciate the opportunity to appear before the subcommittee to present our views on what actions Congress might take in light of the current financial state of the industry.

I am testifying today also in my capacity as the Vice President of the Transportation Trades Department of the AFL–CIO, which represents over 25 affiliated unions and millions, literally millions of workers in the transportation industry.

As the speakers before me have pointed out, the airline industry is in a state of crisis. Company losses are staggering, and airline employees are also paying a stiff price for this downturn. Thousands have been laid off already, with more furloughs to come, we are fearful.

Nearly 18,000 employees at Eastern lost their jobs, and other employees around the industry are agreeing currently to concessions to try to save their airlines. Earlier speakers discussed some of the causes of the industry's financial problems, the fuel spike, the Gulf war, the fear of terrorism, and the recession.

My written testimony identified these factors also. Two factors have not received enough attention, as I believe they deserve, so I will address them here. First, during the leveraged buyouts of the 1980's, several airlines were burdened with debt, debt that served no constructive purpose other than to make money for investors, and in my written testimony I have detailed the disastrous effects that such debt has had on the viability of the affected carriers.

TWA is obviously an example, and the clearest example of how heavy debt has all but destroyed that airline's chances for survival. Second, a principal cause of the current financial crisis is deregulation, itself. Most of you know that ALPA was an outspoken opponent of deregulation.

Unfortunately, we were correct when we predicted the dire consequences of deregulation from the financial turmoil and the bankruptcies to contract degradation and the loss of jobs. In a recent speech Secretary of Transportation, Samuel Skinner, characterized deregulation as a stunning success.

We strongly disagree with the Secretary. We don't believe that dozens of bankruptcies, poor service, and the loss of tens of thousands of jobs add up to a stunning success. In the same speech, Secretary Skinner praised deregulation for having unleashed America's entrepreneurial spirit. Well, the S&L crisis is a grim reminder of what can happen to a vital industry when entrepreneurial spirit is unleashed on an unsuspecting public.

However, ALPA is not here to recommend re-regulation. What we do recommend, however, is that we take a closer look at deregulation and see what we can learn in a decade of experience.

ALPA believes that an objective observer would identify one major flaw in deregulation, and that was the process of implementation. I don't have time to review all of the serious mistakes and the misguided decisions that have been made.

However, in my written testimony I briefly examine mistakes made with respect to three carriers. Eastern is already out of business. Pan Am is in bankruptcy, and TWA is being dismembered. These were once proud and successful airlines, as were Braniff and Continental, and we can't help but note that the major cause of their dire straits have been the inactions or actually the lack of actions of the Department of Transportation, the very Government department empowered to assist them.

I would like to respond to some of the rather serious and, in my view, erroneous statements made by Secretary Skinner regarding labor. I specifically want to refute those that insinuate that employee wages are somehow a cause of the industry's financial problems.

I especially object to his suggestion that pilot wage should fall to those of the lowest paid. The wage imbalance cited by the Secretary is simply a predictable result of deregulation. Not surprisingly, in an unregulated market, the airlines that have earned greater profits have been willing and able to pay more.

Indeed, there seems to be little connection between low wages and financial health. The carriers that are most financially sound have relatively high pay scales. Moreover, since deregulation has caused financial problems for many carriers, pilots at the majority of ALPA airlines have made concessions, both through increased productivity and decreased pay.

Pay concessions by pilots in some cases have been as high as 30 percent. In real dollar terms, the average airline pilot earns less than he or she did ten years ago, and many earn less in nominal dollars than they did several years ago.

Despite Secretary Skinner's contentions to the contrary, the Railway Labor Act has worked as a stabilizing factor to prevent disruptions in rail and air commerce. The act's explicit purpose is to avoid any interruption to commerce or to the operation of any carrier.

It also provides for the prompt disposition of disputes between carriers and their employees. The National Mediation Board, the

Federal agency with the responsibility for administering the Railway Labor Act, has been very successful in achieving its mission. In over 99 percent of the cases in 1990, the disputes have been settled with no interruption to rail or air commerce.

Mr. Skinner's previous position to seek quick solutions to complex problems is never more apparent here. His fix for so-called high labor costs is to repeal or radically change effective legislation that has been successfully accomplishing its mission for years.

Perhaps Mr. Skinner does not know how often the NMB has accelerated the bargaining process because of the needs of the parties, especially when it considered the financial condition of the carriers in dispute, such as Pan Am in 1989 or Eastern in 1985.

Perhaps Mr. Skinner does not know how well the parties that are involved believe the Act works in practice. Without the board's understanding and careful administration of the collective bargaining process, the Secretary's approach could lead to crippling industry-wide disruptions.

I can't help but note that the Department of Transportation is an odd source to call to remove the airline industry from the scope of the Railway Labor Act. The Department has repeatedly and consistently disclaimed expertise in labor relations.

Time and time again the DOT's self-asserted lack of expertise in Railway Labor Act matters has been its reason for refusing to provide assistance to airline employees when airline business transactions adversely affected them, from what Secretary Skinner said this morning. We have no reason to believe that the Department's expertise of the workings of the National Labor Relations Act is any greater.

Today we are considering the competitive viability of U.S. carriers and how Congress must act to protect it. ALPA believes that globalization will be the dominant force in shaping the industry over the next decade. The importance of international operations is already apparent.

In the last half of the 1980's, international revenues for U.S. carriers grew by nearly 15 percent per year, over double the growth rate of domestic growth. This explains the fierce competition for international route authority. 1991 is quickly becoming a water shed year for international aviation.

The key question is, will the U.S. Government, through its actions and policy decisions, pursue a plan to preserve the U.S. airlines' viability and enhance competition or will it rush headlong into globalization as it did deregulation and risk further damage to such a vital industry?

We must also address the issue of foreign ownership now restricted by the Federal Aviation Act. This Act limits foreign ownership of voting stock in U.S. airlines to 25 percent and prohibits foreign citizens from exercising control over U.S. airlines.

ALPA fully recognizes that some of our airlines would, in fact, benefit from injections of foreign capital. We believe, however, there are several reasons why foreign control has been and should continue to be prohibited.

First, the Gulf war illustrates a very real need to protect national security interests. A large portion of the military goods and personnel transported to the Gulf were carried voluntarily with aircraft and crews provided under the civil reserve air fleet agreement. Would foreign ownership affect the continued availability of these services?

Second, transportation is a vital sector of the U.S. economy, comprising almost 18 percent of the GNP. This industry is an integral part of the transportation system. If foreign control were permitted, valuable assets and resources could be diverted from U.S. to foreign airlines, potentially crippling our industry.

Third and more broadly, we must consider how many other American industries have shrunk or vanished from the scene. Do we really want to hand over one of American industry's crown jewels to Pacific Rim countries or to European cartels? It is in this context that we look to the recent hasty DOT decision to permit KLM to acquire up to 49 percent of the equity in Northwest Airlines.

The DOT is either naive or hypocritical if it thinks that a foreign investor is going to pour hundreds of millions of dollars into an airline without the ability to exercise control to protect that investment. As concerned as we are that the DOT decided to raise the equity limit, we are even more concerned that the DOT removed its administrative oversight.

Such oversight could have ensured that the equity holding never be used to control Northwest in the future. The other miracle cure being touted as a fix for the various ills and the effects of deregulation is cabotage. The Canadian Government has informed our administration that cabotage will be on their agenda in the upcoming negotiations next month.

For the first time, U.S. representatives have agreed to discuss this issue, which in itself is an interesting side step because at the present time, cabotage is prohibited by the Federal Aviation Act. We think it should stay that way. The likely outcome of granting cabotage rights would be foreign airlines entering, unrestricted, our largest and most attractive routes now well-served by U.S. airlines.

Our airlines are already in a financial crisis from competing with each other. Should more go bankrupt by competing with foreign airlines, many of whom have financial backing from their own governments? I don't think so, and I don't think you do, either.

With respect to what Congress might do to promote the financial health of U.S. carriers, ALPA has six suggestions, and I will summarize them briefly. My written testimony has more detailed descriptions.

The first suggestion is that the government should develop a plan to ensure the stabilization of oil prices during the Gulf conflict. The airline industry cannot go through another fourth quarter like we did in 1990. We should certainly reflect on the fact that simply a six-month increase in the price of foreign oil can jeopardize our entire transportation industry, and that major airlines can be forced out of business by such an increase. This, to ALPA, is a matter of grave concern.

Second, the government should pursue other fiscal policies to shore up airline cash flow and improve the industry's deplorable financial condition.

Third, Congress should amend Section 401(h) to prohibit route sales that undermine the financial viability of an airline.

The need for such an amendment is made painfully clear by the current effort of TWA to sell its U.S.-London authority to American Airlines. These are almost certainly TWA's most valuable routes and are at the heart of an international route system that the airline has recognized in its own submissions to the DOT as being key to their future.

Fourth, Congress should amend the Federal Aviation Act so that significant foreign investment in U.S. carriers will be subject to prior review and approval by the DOT ensure that a foreign entity will never have actual control over American carriers.

Congress should also establish factors and criteria for the Department to consider when deciding whether to permit a specific foreign investment.

Fifth, Congress should make it clear to the Department of Transportation that it expects the department to be more vigilant in exercising its powers to monitor the continuing fitness of airlines under Section 401(h) of the Act.

In ALPA's opinion, the DOT's unwillingness to recognize the foreseeable adverse effects of airline business transactions, such as route and asset sales, will result in the financial collapse of at least two major carriers. You need only look back at Eastern to gain historical perspective.

Sixth, Congress must resist any efforts to change the statutory prohibitions against cabotage. Permitting foreign carriers to engage in cabotage here will have a devastating effect on some U.S. carriers and will not provide long-term benefits to our consumers or other groups.

Certainly a full congressional inquiry would have to be undertaken in connection with any effort to dilute cabotage prohibitions. That completes my prepared testimony. I thank you for inviting ALPA to testify here today, and I will be happy to entertain any questions at the conclusion.

[The prepared statement of Mr. Babbitt appears on p. 141.]

Mr. OBERSTAR. And we will have some questions for you.

Next we want to hear from Mr. Scheri. Welcome.

Mr. SCHERI. Thank you, Mr. Chairman.

My name is William L. Scheri. I am the Airline Coordinator for the International Association of Machinists and Aerospace Workers, better known as the IAM.

To my immediate right is our attorney, Mr. Robert Clayman, from the law firm of Guerrieri, Edmond and James here in Washington, DC. I am here in place of John F. Peterpaul, who is the Vice President for Transportation Dept. of the IAM, and Vice President of the Transportation Trades Department, better known as TTD, of the AFL-CIO.

He regrets that he is unable to be here because of a conflict in his schedule. The IAM represents approximately 800,000 active and retired employees in various industries throughout the United States and Canada. We are the largest union in the air transport industry representing 95,000 mechanics and related employees.

The TTD of the AFL-CIO is comprised of 25 unions with members in the transportation industries. At the outset, I would like to thank Chairman Oberstar and all members of his committee who provided the IAM and the TTD with the opportunity to express our concerns regarding the financial condition of the airline industry and the woeful failure of deregulation.

We wish to give special thanks to Chairman Oberstar for his efforts and vigilance in assuring that our nation's air transportation system and its employees remain the finest in the world. More than a decade ago, when legislation to deregulate the air transport industry came before this Congress, the IAM forcibly opposed it.

We strenuously argued that deregulation would mean destabilization of the airline industry. We argued that the bill which masqueraded as a pro consumer measure would result in far less competition, higher air fares, a reduction in the margin of safety due to cost cutting and maintenance as well as hardship and unemployment for many airline workers.

We take no pleasure in the fact that our worst fears have come to pass. Carriers since deregulation have resorted to the economic law of the jungle. National Airlines, Republic Airlines, Piedmont Airlines, Ozark Airlines, Eastern Airlines are a few among the approximately 50 casualties of deregulation.

Unfortunately, the deregulated environment became the playground for experts in corporate greed, such as Frank Lorenzo, who bankrupted and destroyed Eastern Airlines and placed its sister carrier, Continental Airlines, in bankruptcy for a second time.

Now, Pan American Airlines, after selling most of its valuable assets, has recently sought protection from its creditors through a Chapter 11 filing. Other carriers are teetering on the brink.

Our organization and the employees we represent are particularly disappointed at the inaction of the Department of Transportation. The DOT has been sitting on its hands while watching this industry go into a downward spiral. In the fourth quarter of 1990 not a single major U.S. airline has reported an operating profit.

Even the strongest carriers in the industry have experienced record losses during this period. United, American, and Delta each suffered operating losses in excess of a quarter of a billion dollars. Frankly, we are shocked that our Secretary of Transportation would state in his speech at the National Press Club a week ago, that we must stay the course in the coming decade as the industry continues to restructure.

Staying the course while the industry continues in a tail spin will guarantee disaster. A situation which is terrible will be permitted by our Secretary to become worse. Right now airlines are not covering their operating costs. Moreover, with our worsening recession, domestic travel will continue to decline.

In addition, the cost of jet fuel has risen dramatically since Iraqi's invasion of Kuwait in August. Even a one-cent increase in the cost of a gallon of jet fuel results in a nearly $200 million burden on the industry as a whole. We take particular offense at the Secretary's unfounded comment suggesting that because some airlines pay less than the industry standards, all employees should be reduced to the lowest common denominator.

Frank Lorenzo proved at Eastern and Continental that in a service industry inferior wages and working conditions are a sure recipe for failure. Secretary Skinner's anti-worker, anti-union sentiment unfortunately has been the hallmark of this and the previous administration.

His attack on the Railway Labor Act as outmoded is absurd and completely outside of his Department's area of jurisdiction and expertise. It is obvious from his comments that the Secretary has little understanding of the great success the Railway Labor Act has had in stabilizing the industry and preventing work stoppage.

The worse example of the sorry state of this industry is undoubtedly Eastern Airlines. The safe harbor that the bankruptcy court was intended to provide a debtor could not protect Eastern against the market forces that have battered the rest of the industry.

Despite Mr. Shagrue's prediction in late November of a breakeven operation by March of this year, Eastern's results were so devastating that it was forced to cease operations on January 18. Since it filed for bankruptcy in March 1989, Eastern has squandered over $700 million in proceeds from assets sales.

It is hard to believe that the creditors of Continental and Pan Am will not have learned from the Eastern experience. Creditors will demand viable plans of reorganization within the statutorily set period of 120 days, or they will seek a guaranteed recovery through liquidation.

Even those carriers that deserve a chance to survive reorganization will be quickly dismantled in the coming months by anxious creditors. According to Pan Am, its survival is dependent upon the consummation of the sale of its London routes to United Airlines.

Based upon this transaction, Bankers Trust has advanced the airline $150 million, which Pan Am is obligated to repay in March. Similarly, TWA stated last week that if the sale of its London routes to American is not completed shortly, TWA will be compelled to file for bankruptcy.

However, the negotiations between the United States and Great Britain over a new treaty that would permit the transfer of these routes broke off last Wednesday. It is indicative of the worsening condition of the airline industry that the future of two major carriers now rests upon whether they can sell off foreign routes which arguably belong to the United States of America.

The causes of the industry's financial difficulties are not a mystery. Deregulation, coupled with a weakened economy, has shrunk airline revenue, while increased fuel costs have played havoc with the expense side of the carrier's income statements. As a result of the war in the Persian gulf, travel to Europe has especially been affected.

United reported on Thursday that its load factor, or the percentage of its seats filled, on Trans Atlantic flights has plummeted to a range of 30 percent to 39 percent from about twice as much—Wall Street Journal, February 1, 1990. Although a carrier as financially secure as United may be able to withstand such significant traffic fluctuations, there is serious doubt that the weaker airlines can tolerate such a massive loss in revenue.

No one with any credibility in this industry believes any longer that the invisible hand of the free marketplace will somehow correct the failures of deregulation. Instead, there can be no doubt without immediate government intervention the impact of the recession, the war, fuel prices, and impatient creditors will push a number of carriers over the brink into bankruptcy and liquidation.

The worse results of deregulation will be accelerated. Secretary Skinner turns a blind eye to the fact that already in Atlanta, Pittsburg, Minneapolis, St. Lewis, and Charlotte, a single carrier controls more than 75 percent of the market. He ignores the fact that in Detroit, Houston, Chicago, and Dallas only two carriers control more than 75 percent of the market.

I am afraid the only competition that remains is the race for monopoly in the few remaining locations where some competition exists. In addition, Mr. Chairman, I would like to point out that.

When these hub and spokes systems were set up as a result of the Airline Deregulation Act of 1978, many of our workers, not only with our union, but across this air transport industry, had to move accordingly into these hubs. They moved into metropolitan areas, and, of course, that increased their living costs because of the higher indexes that they realized in their former city.

We are dismayed and angry that the current Administration is looking to Europe or Japan to cure what ails our airline industry, by permitting foreign ownership of domestic airlines to increase from 25 percent to 49 percent.

High fuel costs, economic recession, and a foreign war are relatively short-term problems. Mr. Skinner's cure, foreign investment, may have been an immediate short-term benefit, but will turn over one of our proudest and most important American industries to foreign control.

We interpret Mr. Skinner's call to get ready for incredible globalization of the airline industry as paving a way for the loss of still another American industry. His unilateral proposal to permit increased foreign control over domestic airlines is nothing more than a political ploy.

There must be a better way to reward our allies for their support in the Persian Gulf.

Mr. Skinner's proposal will most certainly lead toward a handful of foreign-controlled carriers overseeing transportation within the United States. Even less acceptable than increasing the allowable percentage of foreign ownership, is allowing foreign carriers, many of which are subsidized by their own governments, to fly domestic routes within the United States. This proposal, if implemented, will only ensure the demise of the airline industry.

Mr. Skinner said that his policies would create competition like we have never seen before. If he opens up the domestic market, we will see foreign government-subsidized competition like never before, all right, but we will also see the last of our domestic carriers.

Just last week Jeffrey Shane, the Assistant Secretary of Transportation for Policy and International Affairs attacked the option of international roues in bankruptcy proceedings, saying that the international route transfers between carriers were one of the ways that the U.S. airline industry is positioning itself for the future.

Mr. Shane observed that where routes and slots merely go to the highest bidder, it is clear that important public policy objectives are likely to be sacrificed by these transfers, he stated, it should not be determined through a numbers exercise in a bankruptcy court but through DOT and Justice Department oversight and enforcement.

My question to Mr. Shane is, where have you been all these years when airline after airline devoured its competitors and loaded up unsustainable debt burdens?

Where was the DOT when the IAM told you during a fitness investigation of Texas Air Corporation that the company could not sustain the mountains of debt that Mr. Lorenzo had accumulated?

Mr. Skinner said in his speech that deregulation has been a stunning success and asked that we stay the course.

Mr. Chairman, I would like to point out that if it was such a success, why is he proposing to increase foreign ownership from 25 percent to 49 percent, if deregulation is so great?

I don't think it was needed. No one, not even Alfred Kahn, believes that.

If we have learned anything in the decade following deregulation, it is that we are desperate for a mid-course correction.

The IAM believes that this country needs a new Federal agency, not the Department of Transportation to coordinate and review airline pricing policies, within zones of reasonableness to assure that we maintain our domestic airline capability and protect the consumers and employees who are the victims of the economic warfare within the industry.

We need an agency whose sole and exclusive mandate is the protection of the airline industry, consumers, and workers. We need a degree of regulation, and we need it immediately.

In closing, Mr. Chairman, I would like to point out that Mr. Skinner, in his famous speech before the National Press Club on January 23, pointed out that ground workers, as represented by this union and other unions affiliated with AFL-CIO, were paid approximately $51,000 a year. That is the farthest from the truth.

I just looked at one of our better contracts before I came over here, because that statement irritated me. The starting rate on U.S. Air for an air frame and powerplant mechanic, an individual, he or she, starts off at $15.28 an hour, and after 5 years of seniority, progressing through the pay progression as we know it in the industry, 5 years later, that individual reaches a top pay of $20.35, and I am talking about a licensed air frame and powerplant mechanic.

Now, that is far from $51,000 a year. He further stated in that same speech that reservation agents, clerks, janitors as represented by our union, make twice the national average salary. That is also bunk, because we have janitors starting at $7 and hour and progressing to a measly $11 an hour.

On many of our carriers, we have reservations agents starting at $4 an hour and progressing up to, dependent on contract, an average of $16 an hour.

Now, that is not astronomical rates, but for some reason he goes out and tells outright lies, in my opinion, of what is going on in this industry on rates of pay, and he has done it with other craft or classes also.

Thank you, Mr. Chairman, for your time, and it is always a pleasure to testify from our union before your committee.

[The prepared statement of Mr. Peterpaul appears on p. 344.]

Mr. OBERSTAR. Thank you very much for your testimony and for the rather spirited closing and rebuttal to the Secretary's statements.

Frankly, I must say I read those remarks. I was astonished myself from what I know of the industry and the wages paid, and I am glad to have that on the record.

I gather both of you feel there should be some effort legislatively to manage the leveraged buy-out, either the classic leveraged buyouts of the past, or the new generation LBO's, now the expanded opportunity for foreign investment in the U.S. carriers.

We passed legislation in the last Congress, which I referred to earlier today, by an overwhelming vote in the House that regrettably was blocked in the Senate. Is it your suggestion that we should make another try at that type of legislation as partial, at least a partial solution to today's problems, or is the LBO issue yesterday's threat and that we ought to be spending our time on something different?

Mr. BABBITT. We look at the industry from our point of view in almost a two-stage correction. The LBO problem was yesterday's problem. It has brought us today's problems in the industry.

We have a weakened industry. We have a weakened capital base in the industry, and we think, and as we testified, a great deal, due in part to having these highly leveraged corporations, so we have suggested some short interim measures. But I do think for the long term, in the long term to ascertain what our nation's transportation policy will, in fact, be, will require a revisit, should we in fact have a capital-based standard. We have decided that certain industries deserve that.

For example, none of us would expect a bank to open without having a capital base. Why should we expect that an airline wouldn't have a minimum level of equity, a defined set of criteria? So please distinguish between the longer-term correction and a short-term correction of today's immediate fuel spike and financial straits.

Mr. SCHERI. Mr. Chairman, I overall agree with Captain Babbitt with one exception. I think the LBO's are behind us, and I don't think there is any further legislation needed out of Congress on it at this point. There is one exception that is still hanging out there that is our concern from the IAM, and I know it is the Airline Pilots Association also, and that is Trans World Airlines.

As a result of that leveraged buyout, and so forth, we agreed to go into partnership with Carl Icahn in 1985, and as you well know, he fully leveraged that company and he went private and pulled out approximately $1 billion out of the cash drawer. You have just seen the other day that he cannot make payments on his bond interest, and he is once again coming back and knocking on the machinists door, the Airline Pilots Association, and other employee groups on that carrier asking for concessions. I think we have done our share in the 1980's, all the unions affiliated with the AFL–CIO in reeling back many of our contracts to keep them in business.

I think of more interest at this point, and you hit it on the head earlier, is foreign ownership, the 25 percent going to 49 percent. I just share a little of my experience with you, and you are more versed on it than I am, members of your committee, that is for sure.

I was attending an ILO meeting, an experts meeting in Geneva in October, and it consisted of a working group of 10 people from all parts of the world, also government groups from all parts of the world, and employer groups, and I say to you, Mr. Chairman, because I know you are fast on your feet, and so are the people sitting around you, that I think we are really sleeping at the switch, because I have listened to them employers over there, and it was headed up by an individual, and I don't want to get into a name, but it was British Airways, and let me tell you, they are gearing up to come in here, going from 25 percent, because they know we are talking about in this country to 49 percent, opening the door, and the second step is cabotage.

They are very outspoken about it because their markets are saturated over there, and they cannot make any additional profits. Somebody said it earlier from your committee, that the only markets that are still lucrative is the United States of America.

But it is a one-way street. They want to come in here. Let me tell you, we, our organization, we have had more problems with foreign carriers in trying to get fair and equitable contracts for our people here in the United States, because they play tough guy once they are into our arena.

I point that out to you, we are very concerned with it. We don't think——

Mr. OBERSTAR. Excuse me for interrupting, but that is a very sobering observation. It underscores comments that I have made on that subject again and again. First of all, those are airlines majority owned, except British Airways, by their government, and British Airways was taken private very, very recently, so they have deep pockets from a long history of government ownership and protection.

What they are interested in is not return on their investment. They can get better money just putting it in a bank, if testimony we heard earlier today from the airline industry itself is accurate, that their rate of growth has been 6.5 percent, and to break even they need a 12 percent, and the industry average is 14 to 16 percent, that is in the testimony we heard earlier today. And so we say, well, we need foreign capital to stay viable.

Why is the foreign capital interested? Are they just interested in a good rate of return on their dollars invested in the United States carriers?

No; I suggest they are buying something more. I said they are not buying a ticket to the ball game, they are buying a seat on the bench next to the coach and maybe buying the coach, too.

You put it well. Those meetings that you have attended in the International Labor Organization I think are eye openers. I think Mr. Babbitt's statement, what foreign owner would put up 49 percent equity into a domestic airline without control, goes to the heart of the issue. And so they are looking for control and they are looking for access to the domestic market, the largest open, unregulated or deregulated market in the world, and the way that they can build their travel base for their international routes, and the sooner realism sets in the Department of Transportation on that issue, the better off the domestic airline industry is going to be.

Mr. **Babbitt**. I could not agree more.

Mr. **Scheri**. We totally agree with you, Mr. Chairman.

Mr. **Oberstar**. Further, with respect to Mr. Skinner's comments on labor issues, I wanted to mention but the time ran out, and I don't like to bring up the subject when the person isn't here.

However, we should not soon forget the airline mutual aid packet. If you want to look for a device that tilted in the direction of one or another part in the negotiation situation, there was a defensive device that tilted the issue and made strikes extraordinarily long. Since that was abolished, we have had virtually no lengthy dispute.

Mr. Clinger?

Mr. **Clinger**. Thank you very much, Mr. Chairman.

Gentlemen, thank you for your testimony. I gather that you would have given Secretary Skinner about a "D" or maybe a failing grade for his speech last week at the National Press Club. And I think you take exception to his comments about labor's contributions to the problems of the industry.

You, on the other hand, seem to be saying that it has been primarily deregulation that has led to the serious problems we have today. But isn't it also true that the present recession and the increase of oil prices, the threat of terrorism, have been major contributors to the problems we have today? It can't all be blamed on what may be the failings of deregulation, can it?

Mr. **Babbitt**. Let's split that into two pieces, if we could. Certainly the threat of terrorism today, we have seen a very dramatic impact here in the last few weeks. But the underlying fact that the industry cannot cover its operating cost really concerns us and a short-term spike of six months shouldn't put 25 percent of this industry into bankruptcy. That is a concern for us.

The industry even prior to that was having a difficult time on the aggregate basis covering its costs, and we need to look at the fundamental reason why it can't cover its costs. To show a spike in terrorism, this war will in fact be over, this recession will in fact end at some point in time, and fuel prices will stabilize.

Mr. **Clinger**. But you are saying even if all of those things happen, and I would agree that the war is going to be over sometime, but I am not sure the threat from terrorism is going to be over for a long time. That will be a continuing problem for the industry. But if we assume all of that is taken care of, you are suggesting that the underlying ill remains.

Mr. **Babbitt**. Our concern is, and we will go back to the capital base, this country's inability to have a capital base structure for this airline industry is a concern of ours.

The Chairman pointed out very skillfully, he shares the concern we have, and that is if someone wants to invest in a company they do so expecting a rate of return. Right now we are proposing, the Secretary was proposing to mask a problem that we think is deregulation, and the structure that we are operating in, by allowing foreigners to invest in these carriers. Our view would be, if it was a bad investment for a man in New York to make, it is a bad investment for a man in Amsterdam to make.

There is something wrong with the industry. Just bringing forward dollars here won't cure that. It still won't cover its cost.

Mr. CLINGER. I understand. But I am suggesting that some of the reasons they couldn't cover those costs today are indeed a result of temporary things that will go away, and indeed the interest a foreign investor may have will be in looking long term.

I guess my question is, if in fact the Secretary's comments this morning that he had interviewed the leader or the CEOS of every airline, he talked to analysts of the industry and concluded that in fact the capital requirements for the industry today were not available in this country, and that is what motivated him then to consider the foreign investment.

If, in fact, that is true, that we really need to find another source of capital, both now and in the time to come, isn't it reasonable to consider allowing foreign investment subject to very, very tough conditions? I am not sure whether my bill answers all this, but we try to suggest in that bill that we need to make sure that we do retain control in U.S. hands so that in fact we are not giving away more than we are getting, that there is a pro-competitive agreement with the country in question, that there are equal rights.

If in fact we do have a need to develop new sources of capital, why not at least consider that so long as we can have the kind of conditions on it that would ensure that we are not going to get ripped off.

Mr. SCHERI. If I may, Congressman Clinger, on the second question you are posing here, the reason ORGAS is an organization, not to be against it, but there is reasoning behind it. There is 25 percent has been in existence for many years, as far as foreign ownership and the U.S. carriers. And I only know two of them that have bought into a U.S. carrier, as the records show, in my office, anyway, and that is SAS into Continental Airlines, and KLM into Northwest. If this was such a great deal, why didn't they do it at 25 percent and why do we have to change the law to bring it up to 49 when we only have two tiers so far? It is more than that, in my opinion.

As I talk to the European Community and people in parliament over there, they are looking at the big picture. They want to take it up to 49 percent. They also want to take it to the next step, which is cabotage, and come into these markets and knock out the remaining few carriers that we have got left in this industry. It is very obvious over there when you meet one of them. They want to become kingpins such as a United Airlines or an American Air Lines or Delta. And they are very outspoken about it.

I am saying, do we have to go through this again? Don't we ever learn as Americans about shipping our work out overseas and losing the industries here in this country, and now we are going to try to farm out the airline industry? That is why we are opposed to it. We don't think it is needed at this point, Mr. Clinger.

Mr. CLINGER. In other words, you would disagree; you would say that the capital is available here, that we don't therefore need to look elsewhere because given proper encouragement and incentives, capital requirements of the industry can be met domestically?

Mr. SCHERI. Yes, and if I may, what happened is the United States transport industry, you have got to go back to 1978 when Congress enacted airline deregulation into law. You could look at people who were CEOs prior to October 24, 1978, you will find the record shows that there is only one individual that was a CEO at that time and still is, and that is Mr. Edmund Colagee of U.S. Air. Mr. Crandall did not come in until you deregulated the industry.

The problem with the industry is, in my opinion, is that you have got financiers running these major carriers, and what we need is an operating CEO like we had years ago, before deregulation, and they were making money, and they were making good profits.

These financiers come in there and they don't know the first thing about running airlines. And I don't want to get into names, and many of them have admitted to me and my boss that we never knew we were going to get into this type of situation. They know nothing about running it. That is why they are losing money, because they have got a good work force out there. I know we are having some trying times, but I am talking about overall picture. You do not have the old airline people running this like we did before deregulation.

Mr. BABBITT. We actually do support, I have been briefed on the basic premise of what you are proposing, and we agree that there may in fact be a need for some foreign investment, and it should have the appropriate checks; it should have the appropriate administrative oversights and criteria that surround it.

That itself isn't really the concern in question. I guess what more concerns me are two things. Number one, the most recent decision, if we are going to do something like you are suggesting, then Congress should decide that. That shouldn't be done by administrative fiat. That is a matter of concern.

I guess we all should sit here and reflect if we could for a moment on what we are actually saying. We are saying publicly and we are having hearings about the fact that we have an industry in this country that is not good enough, it can't cover its costs to be a decent investment here, so we are going to go to other countries and get them to put up money to run the industries in this country.

I don't see a big difference between that and a foreign subsidiary. We are just going to regulate the company from other countries. So that, I think, deserves a long look.

Mr. OBERSTAR. Thank you very much. The gentleman from Pennsylvania, Mr. Kolter.

Mr. KOLTER. Thank you, Mr. Chairman.

Mr. Chairman and Members of the board, I wish that Secretary Skinner were still here at this point in time because this morning we were given the opportunity, under the five-minute rule, to interrogate him, and I wasn't able to conclude my interrogation.

I wanted to indicate to him that on page 4, he indicates that most airlines have not been able to bring their labor costs under control. He goes on to mention the high salaries that pilots and copilots are making, and he talks about the high costs to him and to the airlines of the salaries of ticket agents, ticket clerks, janitors, baggage handlers and so on and so forth. And he concludes: "One might mention whether something is seriously out of balance in the airline labor market."

Further on, on page 6, he indicates that the Railway Labor Act is outdated. So I said, "Mr. Secretary, do you believe that removing the airline industry from the Railway Labor Act would reduce the number of strikes?" And for the life of me, Mr. Chairman, and ladies and gentlemen, I don't recall what his answer was. I think he consumed my five minutes without answering my question. So I am going to pretend he is here and give you my observation and ask you the question I was going to ask him.

The observation I have here is that Secretary Skinner is the finest Secretary of Transportation that I have worked with since I have been a Member of Congress. But in my opinion, he sounded more like a Secretary of Labor than a Secretary of Transportation.

I understand that one of the larger airlines is in the process of negotiating with their pilots.

I wonder what effect the Secretary's testimony today in front of the TV cameras, in front of the Members of Congress, in front of the American people, might have on the negotiation process now in effect between this carrier and that union.

Would you answer that for me, please?

Mr. BABBITT. Yes, sir. I was very dismayed. I don't represent the pilots that you speak about. But there is in fact a major carrier in negotiations right now, and I was flabbergasted personally that he would go so far to so much prejudice the public for what is and has been for 50 years an open collective bargaining process.

The act itself contemplates getting to a solution. If you really study the act and look at what it is designed to do, it is to bring the parties together at the end, and it has been incredibly successful.

Now, I listened—I wasn't actually present, but when the Secretary went through and pointed out all of the misstatements, I might add, about labor and the high cost of salaries and particularly pointed out pilots' salaries, I wondered why since he took the time to point out how high and the devastating effect of the pilots' salaries, he didn't point out in the quarter of 1980, those costs ranged from 35 to 200 percent increases over the previous quarter. Why were we singled out?

This airline industry has some severe problems. Part of those problems are oil prices. But he very conveniently overlooked those sides, real problems.

Right now, if you take the ticket tax that comes out when the dollar hits the counter, more money comes off of that ticket than all the pilots are paid collectively, so they tax the airline harder than we work for them. So in terms of compensation and competition for that revenue dollar, none of those were brought out in his statements. And I was, I guess, concerned very much, and I would have been outraged even more so if it had been a pilot group that I represented, and a neutral government body Secretary stood before a group and prejudiced negotiations. I thought that was uncalled for.

Mr. KOLTER. Those were my conclusions also. It just reminded me of a hearing we had here with the Chairman, Jim Oberstar, of this committee, when Eastern Airlines came before this committee, and they indicated that the reason they were in trouble was the fact that they had high labor costs, yet we were able to prove that the other airlines were paying far more monies to the air pilots, crews, clerks, janitors and baggage handlers, and they were surviving. So it wasn't a case of too much money. It was a case really of bad management.

Mr. BABBITT. I couldn't agree more, and I wouldn't belabor the point that has been made by other speakers, but this is a service industry, and well compensated employees provide quality service. And unfortunately, due to a lot of other reasons, whether it is overleveraged, high-interest burdens, the first place they turn is labor, and the low costs go along with all of the cutbacks.

You have heard us testify before not just as the service had fallen away. We think the levels of safety and the underlying support issues fall away as well. Unfortunately, service is the direct interface the traveling public is faced with.

Mr. KOLTER. Thank you very kindly.

Mr. OBERSTAR. The gentleman from Tennessee, Mr. Duncan.

Mr. DUNCAN. Gentlemen, I thank you for your patience.

Captain Babbitt, I assume since this hearing is dealing with competition in the airline industry, I assume that most Members on both sides of the aisle would like to see more competition in the airline industry and a larger number of stronger competitors. is that something that you would also like to see?

Mr. BABBITT. Yes, sir, it is. We are concerned that the shrinkage in the airline industry, the fewer and fewer players, and an earlier speaker observed, focused on the fact that there were three auto companies. We shouldn't just focus on whether there were three or four, but the fact that those three or four may well have geographical monopolies which makes competition even harder to accomplish. That is a desire of ours, is to have a healthy, competitive industry.

Mr. DUNCAN. It will stand to reason, at least it would seem to me, that there would be more opportunities for pilots, a larger number of pilots, if there were more companies and more competitive spirit within the industry. Do you think so also?

Mr. BABBITT. A healthy overall airline industry, yes, sir, with a capital base that would provide expansion.

I focus again on a capital base. Having more carriers lose money won't provide anything for anyone.

Mr. DUNCAN. What can we do to bring about more competition within the industry? Because, you know, Secretary Skinner this morning kept going back to the lack of capital. Is that 90 percent of the problem, or 99 percent of the problem, or are there other factors that enter into the quotation here?

Mr. BABBITT. The competition that has existed in recent times has unfortunately been rather cut-throat competition, competing for cash flow rather than real equity competition that has to exist in a free enterprise situation.

If we had, and I realize we are now talking about spilled milk, but had we not allowed, had the DOT fitness standards been applied and monitored, at least the warning flags would have gone off a long time ago that we needed to change the standards, we needed to broaden the equity base and not allow so much leverage. Unfortunately, we are here. That has happened because it wasn't monitored, because those fitness standards were not applied.

When you take some of the carriers and look at Eastern Airlines, where the Department of Transportation said, this is healthy, this airline meets all the fitness requirements, when it wasn't in fact—any prudent investor would have looked at that and said, I'm not going to put money in that operation. So that is symptomatic of what went on.

I think what we have to do is look forward and say that we do in fact need some capital base minimums. We do need to have those threshold things in place. And the question is, how do we transition? If Congress decides that that is our goal and that is what the U.S. should have, how do we make that transition?

I think you heard a good discussion, increasing slots, doing a variety of other things, or creating the abilities for new carriers to come forward would certainly be part of that operation.

Mr. DUNCAN. I voted last year to put some restrictions on the leverage buy-out problem and hopefully to try to future Lorenzo-type situations. But now I hear that that is not a real problem now.

We have a briefing paper from the committee's staff that says barriers to entry are particular computer reservations systems. Is that a great barrier to entry in the market today, the computer reservation system?

Mr. BABBITT. I am not the resident expert on computer reservation systems. However, I understand the background of it, and I realize it is a threshold restriction.

Mr. DUNCAN. Let me ask you this. Just in plane east Tennessee-like language coming from a non-expert, let's say most people in most industries think about how they would run the industry if they were in charge. And I assume that many pilots would like some day to run the airline. Or they would like to do it.

So let's say that you and four or five other pilots got together one day and decided you wanted to start a small airline company. Is that possible today? And if so, if it is possible, what would be your biggest hindrances to starting up? Is capital the biggest thing? And assuming you got by the capital situation, assuming you wanted to start a small airline with one or two airplanes, tell me about that. Could that happen today?

Mr. BABBITT. It could happen. It happens routinely. It depends how ambitious carriers want to get. If you ask me personally, first I would have to start off with those silent wages that I would pay those employees to get them started so they would provide great service.

Beyond that, there are things that have to be dealt with, and believe me, I understand the CRS issue, which is what I think you are trying to get to.

Mr. DUNCAN. Well, what I am trying to get to is, is there something we can do to try to encourage that kind of thing?

Mr. BABBITT. Well, if there are perceived barriers out there, they should certainly undergo scrutiny in Congress. Some of the barriers are slots, and be sympathetic to the fact that I represent pilots of 51 different carriers and they are on both sides of the CRS issue. We haven't taken a strong stand on that.

The other barriers that are out there could well be the equipment purchase itself. The actual acquiring of equipment sometimes is very difficult to do. These carriers go out, strong carriers go and buy up all the delivery slots.

We even now have speculators, almost futures markets, if you would. They will lease the aircraft or sell the delivery slots of them. If you can't buy an airplane, no matter whether you have slots and CRS, you still can't start an airline. Any of these could be, but it is still a broad question as to actually where you start.

Mr. **Scheri.** Congressman Duncan, taking it a little step further here, I think we suggested in IAM's testimony, we would like to bring back DOT. We have operated before when CAB went out of business.

I think they did a good job. Sometimes they were quite lengthy in getting involved in foreign affairs, but we are saying, a happy medium, in between, what DOT has basically done in rubberstamping mergers and acquisitions and the list goes on and on.

We are saying, set up another industry. Let them come in there so a small carrier could start up, not by putting up a million dollars, because I remember a million dollars; some years ago it was controlled by the United States Government. Now we have let it loose and carriers are selling for millions and millions of dollars, just like these foreign carriers trying to come in here now and getting part of our action.

I think that is what is needed. I say we have to set up an agency to review these routes for start-up carriers and also major carriers and come up with reasonable fares which we have suggested many times to Congress. Plus 10, minus 10, not what is going on in this industry like you heard today, earlier today, talking about 92 percent of the market as being discounted and I believe the Congressman from New Jersey says, How come they are using money? Well, it is very simple.

Why did Eastern Airlines go out of business? For the simple fact they had to carry 80 percent load factor to break even. Well, they don't have that many seats, even though he increased the first-class section on Eastern.

We have got to look at this situation because it is running away from us. And you know what? Whoever made this statement earlier, there is going to be three or four major carriers left, that is what they are preaching in Europe. It is already on record. They know the four carriers. And somebody else pointed out from the carrier a few minutes ago, it is going to come down to four. Secretary Skinner said five. And that is what happened as a result of deregulation, I am sorry to say.

Mr. **Duncan.** Let me ask you something else on another point. For years we have run up huge deficits, and we have a national debt that is totaling $4 trillion, roughly. That has forced our interest to remain at levels of 3, 4, 5 percent higher than most other developed nations.

Those of us on the conservative side of the aisle have said that if we don't bring our own fiscal house in order, it is going to give foreign business a competitive advantage. Over the years that is going to lead to an increased percentage of foreign ownership of our best businesses. And that seems to be coming about now, and I don't like that.

I don't think it is good to see foreign ownership of our best businesses and properties. I don't think whether it is the airline industry or some other industry. So knowing that I feel that way and that I am against the increase in foreign ownership—but let's just ask the hypothetical question.

If you were Secretary of Transportation or I was, and an airline official came to you and said. We're going to go under, and they showed you the statistics and convinced you that they are going to go under. But we have this foreign company or foreign businessman who wants to invest, and this is the only thing that is going to save the airline, what would you do in that situation?

Mr. BABBITT. The first instance, in going back to Congressman Clinger's proposal, there is some merit in that. The alternative is having the carrier go out of business. That is not wholesome, and I agree with you.

However, the DOT should have criteria. I would be very suspect to have these done on a subjective basis, on a carrier-by-carrier basis. I don't think that is wholesome. I don't think that carrier going out of business is wholesome.

So I think that somewhere in between, if the Department had criteria, had standards, had a process to monitor that investment, and also looked beyond the actual cash investment, there is another concern. You haven't even begun to mix the mixtures.

We are focused only on the equity. What about a carrier that has capital leases on 70 or 80 percent of the equipment and 49 percent, and a high concentration of bilateral agreements into a city where they have made those investments? At what point does this get to an unacceptable level?

I think if we sit back in the light of day and draw out the criteria, we can find middle ground. What I would not want to see and I don't think you would either, if you accept the premise, as I do, and maybe you and I would disagree on this point, but I accept the premise that deregulation has not been terribly successful.

We boiled down, and I can go back and revisit all the statements, we should be swatting new entrants away like flies right now. But we are not. The only flies around are the corporations over the airlines that have died. This has not been wholesome. Something went wrong.

So what we are proposing to do is have competition from our sources come in. If the first premise didn't work, the second won't either, and my fear is when we finally wind up—when there is no other place to turn to, where are we going to go next for capital when it doesn't work this time? The two dominant carriers may well be one foot in Europe and the other in the Pacific rim. And that is what I don't want to see us head toward.

Mr. DUNCAN. One last brief question that is sort of related.

There was earlier testimony about some kind of minimum capital requirement, and I can see some possibility in that or reasonableness of that.

But have you or have you see or heard of any study or has any work been done showing what would be a minimum acceptable capital level or what type of requirement would you come up with if we were to consider something like that?

Mr. **Babbitt**. Certainly I would look at a ratio.

Mr. **Duncan**. Right. You would have a higher list of the smaller airlines than of the higher airlines.

Mr. **Babbitt**. And it is a way, if the airlines remember and the banking industry will use and we are all familiar with how the Federal Reserve works, by changing those requirements, they have the ability to make the industry a little healthier, if you would, maybe open up a little more oxygen by changing those requirements. And they do periodically.

And it was just one of our thoughts, and we are suggesting several, that making these—the ability to help the industry before it gets too late and in the future sets the minimums to come into the business.

I guess when you look at some of the airlines that come into the business and the fact that they have been purchased literally with their own money, all borrowed, no real capital investment in the corporation, and then they are bankrupt.

They were healthy airlines when they started, and we have found a new alchemy that literally turns gold into sea water, that is not healthy.

Mr. **Oberstar**. The gentleman from Mississippi, Mr. Parker.

Mr. **Parker**. Your testimony has been extremely interesting, and I have enjoyed a lot of it.

One thing that—I am glad everyone is talking about the long term aspects. I think that is the key to this whole situation that we are in. We have not had a lot of the long-term discussions that should have been occurring for some time now.

And I agree with you that cabotage is the ultimate aim. The European business community has always looked from a long-term standpoint as far as investment. They look in terms of decades and centuries, whereby we tend to look at the next quarterly statement, knowing full well that freedom of someone coming into being able to come into the airline industry and establish something and start is a major problem because of slots and so forth.

Knowing there is a problem there, I am extremely interested in what you said, Captain, about capital, raising capital, knowing full well that Europeans and Asians, Pacific Rim, have some additional capital—in those areas—that we do not have in this country. I mean, just in general.

Now, there are different ways to raise capital. You can raise capital without a person being involved. I mean, I am going to throw something out, and you tell me what you think.

You have got Ginnie Maes. You have got Fannie Maes. We can have Flightie Maes. We can having something for the airline industry.

It would be a system whereby capital could be raised for that industry. Knowing full well that a lot of people are not willing to get involved, give me your impression of how you would think that would work, how you would view that from the standpoint of employees of the airline.

Mr. **Scheri**. Without being an expert in finance, but I do enough of it.

Mr. PARKER. All the experts in financing are going broke.

Mr. SCHERI. I understand. I think the theory is good, and I think we should have been doing it for the last 12 years as these carriers got in trouble. And for some reason, they never really gave a hoot about it in our country.

Just like deregulation was supposed to create more carriers; okay? I testified in this room in 1977, and you told me I was crazy, there is going to be all kinds of carriers as a result of deregulation.

But we went from 38 pages down to 36 mega carriers right now. But this government talking to people in this country should intervene. I don't care if it is an airline industry or some other major industry which they have done.

The Chrysler situation, the Lockheed, just to name a few. Not a lot of major carriers, like in our case, go out of business if we can stop it.

I guess what irritates us is workers and the people we represent as workers, it's just like people at DOT, they say, oh, that is another one down the tube. That means more marketplace for United or Delta or Northwest, whatever the case may be, and they become stronger and stronger.

And I will answer Congressman Duncan's question up there, it's hard for a new guy to get started out in that block, if we are all involved in, which you said earlier, Congressman, with a form of playing monopoly. They are out there. It's a fact of life right now.

I mean, I don't like to see it. I don't like to see these companies go out of business. You think I like to see Eastern Airlines out of business?

This gentlemen flew with them for 22 years. We represented them since 1939, our union. We don't want to see this happen.

But DOT and this Administration see it different than the unions of this country.

Mr. PARKER. Eastern has gone out. Being a funeral director, I know something that is dead when I see it.

Now, my question is this: Is there anything you all would have done differently, I mean? You have had enough time—one of the closest friends I have got in the world is an Eastern Airlines pilot. The most conservative Republican I have met in my life.

Mr. BABBITT. Not any more.

Mr. PARKER. No, he still is. But I have seen it destroy his home, and he has got a son the age of my son. We are very close. Is there anything—I know you have searched yourselves to see what you would have done differently, what you would have handled differently.

Is there anything you would have done differently about this situation, knowing full well you had a man in control that was gutting the company any way he could?

No reason to get into that. Everybody—no one in this country names their children Lorenzo. That is not the point.

The point is, what would you have done?

Mr. BABBITT. Well, that is—you know, asking me to evaluate an incredible complex series of events.

I go back to one point in time that if I could have made the decision myself, here we had an agency called the NMB, the National Mediation Board, who oversees the Act, and their sole purpose is to avoid disruption. And that is their sole function, is keeping harmony. And it contemplates conflict.

That is why they have the Act. Someone said, we need this. And the people that oversee that Act made a recommendation to the President of the United States and said, this is going to be a serious disruption, and we recommend to you that we invoke the Presidential Emergency Board to bring about a solution here.

Now, without arguing the merits of the bargaining positions at the table, but with the knowledge in full that the President of the United States at that time had the option to appoint all three members of the panel that would then oversee and rule on the dispute, and the machinists were willing to accept the binding award of the three men that the President of the United States got to appoint, at that point in time, I think I would have accepted the NMB's recommendation and let them recommend a solution.

Those two parties had obviously let emotions, had let a lot of things come between them, a lot of rhetoric.

I won't comment on any of that. I just—if that was the one point, if I could revisit, I would change.

Mr. PARKER. I understand emotion and rhetoric. I have been married 20 years.

Mr. SCHERI. Congressman Parker, getting back to the nitty and the gritty, because I guess we are the ones that struck the carrier on March 4, 1989, Captain Babbit is totally right. We did accept the proffer of arbitration. We usually don't.

But that thing was so jammed up by Lorenzo and Company, he just—you could never get a deal with him; okay? So we are going to the agency that could possibly get him to agree to binding arbitration.

We accepted as an organization. He turned it down. We then moved into Congress to set up a Presidential Emergency Board under the Act. And, of course, I wish he was in the room, Mr. Skinner. He sounded better than Mr. Lorenzo on TV.

You know, Mr. Bush is not going to intervene, let labor work it out with management and so forth, and you know the end result. I don't think we would have done anything different.

But in October of last year, I revisited that situation with the trustee, Marty Shugrue, and believe me when I tell you, this union bent over backwards to try to settle the strike and make concessions because Lorenzo was out of the picture. He was the acting trustee.

He flatly told us no. He got on an airplane and flew to the West Coast after two days of negotiations, and he basically said no because he was protecting the replacement workers that Frank Lorenzo hired because of a crazy law that has been in existence in this country and the way he violated it.

No, we would have done nothing differently. Many of them people are my friends. They lost their homes, their cars. I have seen suicides, divorce, whole works.

But let me tell you we got very few complaints; but let me tell you we would still vote 97.7 percent for a strike tomorrow.

Mr. OBERSTAR. Gentlemen, thank you very much for your splendid testimony, and very thought-provoking, and very substantive comments on each of the issues that we asked you to address.

Thank you for being with us, as we—we know you will continue to be with us as we work our way through these problems, attempting to keep this industry financially healthy and competitive and growing.

Mr. **Babbitt**. Thank you again for the opportunity.

Mr. **Scheri**. Thank you, Mr. Chairman, for the opportunity.

Mr. **Oberstar**. Good to see you.

The next panel consists of Dr. Steven Morrison, Department of Economics at Northwestern University; Paul Dempsey, Professor of the University of Denver School of Law; and Dan Kasper of Harbridge House.

Gentlemen, thank you very much for being with us. We greatly appreciate the thoughtful academic and marketplace attention given to the problems of the industry that each of you brings to our consideration of this subject.

We have read your testimony ahead of time, and I compliment each of you on a very productive insight into the industry's activities and for charting the way to some solutions that we and the Department of Transportation should consider.

Dr. Morrison, would you begin, please.

TESTIMONY OF DR. STEVEN MORRISON, DEPARTMENT OF ECONOMICS, NORTHWESTERN UNIVERSITY; PAUL DEMPSEY, PROFESSOR, UNIVERSITY OF DENVER, SCHOOL OF LAW; AND DAN KASPER, HARBRIDGE HOUSE

Dr. **Morrison**. Mr. Chairman, it is my pleasure to be here today to talk about the adequacy of competition in the airline industry. My comments are largely based on ongoing research conducted with Cliff Winston for the Brookings Institution.

Many people predicted that airline deregulation would result in many carriers, perhaps hundreds, with many providing only point-to-point service in a particular market niche.

It was predicted that competition would flourish, bringing with it low fares. We certainly have not ended up with many carriers. On the contrary, there remains a handful of carriers in the industry, the only question is how large a handful.

I believe the reason for the inaccurate prediction was the failure of analysts to appreciate the overwhelming importance that hub-and-spoke route systems would have in the deregulated marketplace.

When assessing the degree of competition in the airline industry most analysts refer to the "national market." For example, and we've heard this today, they cite that at the time of deregulation in 1978, the largest eight airlines accounted for about 82 percent of domestic passenger miles. Today this figure is about 92 percent, having fallen to a low of about 72 percent in 1985 before the merger wave began.

By way of comparison, the beer industry in the U.S. is about the same size as the airline industry—$50 billion in annual revenue—and is more concentrated with the largest five firms controlling over 90 percent of the market.

However, there is no "national market" for passenger miles or for beer. Just as the "beer market" is thousands of stores and bars, the markets for air transportation are thousands of point-to-point city pairs: Washington to Dallas, Chicago to New Orleans, and New York to San Francisco, to name only a few.

Competition flourishes at this level. As detailed in my figure 1, of the prepared statement, the number of effective competitors per route has risen from one and a half in the fourth quarter of 1978 to 1.96 in the second quarter of 1990, just 0.04 below its all-time high of 2.0 in the second quarter of 1986.

Another perhaps more intuitive way to look at the extent of route-level competition is detailed in my figures 2 and 3 of my prepared statement. These show the percentage of air travelers who travel on "competitive" carriers (i.e., those with a route market share less than 20 percent) and those who fly on "monopoly" carriers (i.e., those with a route market share greater than 90 percent).

Passengers captive to monopoly carriers have been cut nearly in half: from 26 percent in the fourth quarter of 1978 to 14 percent in the second quarter of 1990. During that time, passengers flying on competitive carriers more than doubled, from 8 percent to 18 percent.

As an exaggerated example, which is preferable, 100 carriers nationwide with one on each route, or five carriers nationwide with five competitors on each route? I believe that most people would prefer the latter. However, there is a concern with having only a few carriers nationwide that meet each other in many market settings: collusion.

Some analysts believe that the similarity of air fares on rival carriers is evidence of collusion. However, my work on the factors affecting travelers' choices of airlines indicates that a fare difference of only $10 (for two otherwise identical carriers) is sufficient to cause the market share of the higher-priced carrier to fall by 7 percent, a sizeable loss. Since airlines produce very similar products, it is not surprising that fare differences are small.

Another area of concern is the increased domination of carriers at hub airports. Once again, measurement is the key. Nonetheless, the vast majority of studies, mine included, find regardless of route concentration, higher airport concentration leads to higher fares.

But do consumers at hubs suffer? This is harder to answer because cities that are hubs receive better air service than they would if they weren't hubs.

My research indicates that the average hub has direct service to 75 percent more cities and 120 percent more daily departures per city served than it would if it weren't a hub. Travelers at hubs pay higher fares, yes, but they receive a higher quality product.

However, I believe that because hub and spoke is an efficient system that is less costly for airlines than point-to-point transportation airline profits are higher on their hub operations than at other airports.

But the issue of concentration at the national level, at the airport level, or at the route level is of interest because of its effects on fares.

Figure 4, of my prepared statement, shows a plot of real domestic airline yield (revenue per passenger mile). We see that after adjusting for input price changes, fares in the second quarter of 1990 are 5 percent below what they were in the fourth quarter of 1978, and this does not include the effect of free tickets awarded under airlines' frequent flier programs.

But one should not interpret these figures as indicating that deregulation has lowered fares by only 5 percent. Deregulation effectively began in 1976 when the Civil Aeronautics Board began a more liberal interpretation of existing statutes.

Between 1976 and 1978, airlines' costs increased by 20 percent but air fares increased by only 4 percent. Furthermore, in a more detailed analysis, I calculated what fares would have been if they continued to be set in the way they were under regulation. This is shown in Figure 5 of my prepared statement.

During the 11 years of deregulation, fares on average are 18 percent below what they would have been if regulation continued. This amounts to a saving to air travelers of about $6 billion annually (1988 dollars).

Let me now address more directly some of the issues that are the focus of this hearing. Although I have no crystal ball, one is not needed to say that the current financial condition of the industry is not good, and it will not improve if fuel prices remain high and if the recession lingers or the war-related slump is protracted.

I would not be surprised, especially given the dramatic decrease in international bookings recently, to see another carrier fail. Yes, financially troubled airlines will sell assets in an attempt to survive.

Of course, the best assets to sell are those that are most valuable, leaving such airlines with less to work with. So unless the affected companies make significant structural changes, asset sales will only delay the inevitable.

The airline industry has always been, and will remain, a cyclical industry. The current recession will not affect that. The current recession is one of the causes for airlines' poor financial performance.

Second, the run up in fuel prices saw the price of jet fuel more than double. Since fuel is the second largest cash expense of airlines, this has had a large impact. Fuel prices are now only 14 percent above their level during the first week in August, but this obviously could change in the weeks ahead.

Deregulation's role in all this is that there is no regulator to intervene to arrange mergers with healthy carriers to stave off bankruptcy. Airlines must arrange these on their own and be subject to antitrust scrutiny or lack thereof according to some speakers today.

With respect to increased concentration, as I mentioned earlier, although there are fewer carriers nationwide, there is nearly as much competition today at the route level than ever before.

I expect the consumer benefits of deregulation to continue. But this does not mean that deregulation in 1991 and beyond will offer fares as low as in 1986.

The central question is, however, is there a role for the Federal Government in enhancing competition in the industry? Let me list and evaluate several areas that have been suggested from time to time.

Foreign ownership and entry into domestic city pair markets: I believe this would be beneficial to travelers. I believe the burden of proof should be on those opposing foreign ownership and entry.

I might add, as well, from my perspective, one of the reasons is to provide a fee for air-regulated services.

The cost of fuel: The cost of fuel has fallen over the last 17 weeks so that it is now only 14 percent above its level during the first week of August. Nonetheless, if there is reason to believe that the behavior of fuel suppliers is anticompetitive, this should be dealt with even if the airline industry were not experiencing financial hardship.

On the other hand, if the fuel industry is behaving in a more or less competitive way yet the airline industry suffers, so be it.

Frequent flier programs: I have mixed emotions towards frequent flier programs. On the one hand, they are ways for companies to develop "loyal" customers. I might add, if you have to buy loyalty, it is not clear who your friends are.

On the other hand, one troubling aspect of frequent flier programs is that they appear to give an advantage to large carriers, but not because large carriers have lower costs. I believe that an in-depth study of frequent flier programs is worthwhile.

Allowing financially weak carriers to sell international routes, or for that matter any carriers: I believe that the "scarcity value" of these routes should be the property of the U.S. government rather than the carriers that were selected to serve them. This is also my view on the ownership/sale of airport slots that were given to carriers.

However, it is clear that airlines and financial markets had every expectation that current route authority is an asset belonging to the carriers involved. My view is that any additional international route authority not be subject to sale.

I might also add based on the comment made earlier today that the higher price paid for those routes don't lead to those higher fares. It the higher fares that lead to the carrier's willingness to pay the high prices.

The final issue is whether there should be re-regulation of routes or fares. To the extent that there are competitive problems in the industry, I believe they stem mostly from airport access issues.

The institutional/contractual arrangements between airlines and airports date from the regulated era when issues of competitive access were not relevant.

I believe that current practices such as long-term leases, majority in interest clauses, and slot ownership and sale should be looked at in-depth to see to what extent they do, in fact, reduce competition and appropriate action should be taken. However, I do believe that fare or entry regulation would be a step—perhaps only the first of many—in the wrong direction.

Thank you, Mr. Chairman.

Mr. **Oberstar**. Thank you, Dr. Morrison. I appreciate your views. I have some questions thereupon.

Mr. Dempsey.

Mr. **Dempsey**. Chairman Oberstar, the magnitude of the crisis with which the airlines are confronted is unprecedented in the history of commercial aviation, domestic or abroad. Two weeks ago, Eastern Airlines ceased to exist. The tragedy that was Eastern's could be dismissed as an aberration, if it were not for the fact that four other major U.S. airlines—Continental, Pan Am, TWA, Midway—are liquidating major operating assets to stay aloft. Operating assets, Mr. Chairman, not hotels and rent-a-cars.

The arms and legs of the companies are being sold to try to keep these airlines alive. Pan Am and Continental also stumbled into bankruptcy, Continental for the second time. Some people called it Chapter 22 bankruptcy. More will likely follow.

The airline industry has suffered recessions and higher fuel costs before. In the 1970s, fuel costs tripled.

Yet we never sought the dismemberment of airlines in this magnitude. Never before have we seen major airlines collapse. Transportation Secretary Sam Skinner has proclaimed the deregulation experiment a profound success, declaring that the deregulation debate is over.

He should also suggest that Congress just write the half trillion dollar check to bail out the savings and loan institutions and not ask why. The cause is the same in both instances.

The cause is deregulation. All the world's airlines are paying higher fuel costs and this is a global recession, not just a domestic recession. But only America's airlines are in bankruptcy.

Only American's are selling off operating assets, despite the fact that international aviation fuel costs more than domestic fuel.

Why is the United States airline industry disintegrating?

Unlike their foreign cousins, the U.S. airlines have been deregulated. They have been ravaged by a decade of deregulation. What is it about deregulation and the contemporary circumstances of the crisis in the Middle East that might be causing them to hemorrhage dollars unmercifully?

Three reasons. First, under deregulation, the United States fleet degenerated into the oldest in the developed world. Older generation aircraft gulp more fuel. TWA and Pan Am fly the oldest jets in the geriatric U.S. fleet.

Deregulation also produced the fuel guzzling hub-and-spoke phenomenon—the dominant mega-trend on the deregulation landscape.

Airlines prefer them because they can charge consumers 27 percent more at the concentrated hub airports, according to the GAO. Today a single airline controls more than 60 percent of the gates, the passengers, the take-offs and landings at about 18 major airports. There were none so dominated before deregulation.

Hubbing requires that airlines fly passengers more miles in smaller aircraft with more takeoffs and landings. Funnelling passenger through constipated hub-and-choke operations not only squanders billions of dollars of business traveler opportunity costs, it also burns fuel wastefully.

Third, deregulation freed corporate raiders like Frank Lorenzo at Continental and Eastern and Carl Icahn at TWA to loot airlines, leaving them with suffocating debt.

TWA owes $3.2 billion in long term debt, lease obligations, and unfunded pension liability. Continental suffers from about $2.2 billion in debt.

If Eastern is fully liquidated, that could expose parent Continental to an additional billion dollar in unfunded liability and the transfer of assets into the Texas Air empire at less than fair market value.

Interest expenses at Eastern and TWA were running 8 percent last year. That is the highest in the industry. Anybody who knows anything about this industry knows eight percent is more than the margin between profitability and going broke.

The airline industry story could be viewed as a curious aberration if the concentration epidemic was not also plaguing every other mode of transportation.

Under deregulation, the major railroads dwindled from 12 to seven with no new entries. Two-thirds of the general freight trucking companies have collapsed with no significant new entry. And with the merger of Greyhound and Trailways, the bus duopoly became a monopoly and is now in bankruptcy, with no significant new entry.

I want to talk about foreign ownership.

I think this is a very dangerous alternative to the crisis now plaguing this industry. In 1989, in testimony given before this committee, Secretary Skinner said "We concluded that KLM's ownership of 57 percent of NWA's total equity, together with the existence of other links between the carriers and KLM's position as a competitor could create the potential for the exercise of influence and control over the carrier's decisions. This would be inconsistent with the law".

Remarkably, that which Secretary Skinner, not that long ago, declared would be inconsistent with the law, he now proclaims to be well within the law.

Foreign ownership creates serious anti-competitive concerns. Both KLM and Northwest serve the United States—European market, KLM through its bottleneck hub at Amsterdam and Northwest through Boston and Minneapolis.

How vigorous a competitor can we expect Northwest to be with its primary shareholder, its owner, in effect?

Moreover, most foreign airlines are owned, in whole or in part, by their governments. Monopoly is not the antithesis of competition; socialism is.

A government-owned or subsidized airline doesn't have to make a profit to stay alive. Therefore, it lacks a proper competitive discipline. Their presence in a free market creates an unlevel playing field.

The government treasury of a major airline can subsidize losses or underwrite capital requirements necessary to develop monopoly positions with financial resources beyond the wildest dreams of privately owned companies.

At the outset of deregulation, some predicted that ultimately only a handful of major airlines would survive. Some also predicted this handful of airlines would become nationalized wards of the State. Never could they have realized what ultimately would happen is not that they would become wards of the United States Government, but they would become the wards of foreign governments.

Today, 8 percent of Northwest Airlines is owned by the government of the Netherlands. Today, 8 percent of Continental and Eastern Airlines is owned by the Scandanavian governments. Foreign airlines don't need cabotage if they can buy access.

This really is the backdoor to cabotage.

Now, we have embarked upon the partial nationalization of airlines not by our government, but by foreign governments.

And there are also the national security implications of foreign ownership, Mr. Chairman. Foreign ownership restrictions have long existed in a number of our infrastructure industries, in airlines, in intercoastal and inland shipping, telecommunications, broadcasting, electric power production, and nuclear energy.

These restrictions were added to our law not because of blind xenophobia, but because of legitimate national security considerations.

Aviation is absolutely essential to national security. As operation Desert Shield confirms, the nation depends upon the aircraft or our domestic airlines committed to the Civil Reserve Aviation Fleet [CRAF] as the essential logistical means to ferry troops and supplies to distant battlefields.

We need a CRAF fleet for airlift capacity in time of war. In this exercise in which we are now engaged in the Middle East, the CRAF fleet was called to active duty for the first time since its creation in 1951.

It has been the most massive airlift since the Berlin Airlift of 1948.

During only a few months of activity, CRAF planes have flown thousand of missions, carried hundreds of thousands of passengers, mostly soldiers, and hundreds of thousands of tons of aircraft cargo.

We don't have to look for wild examples of foreign ownership that might endanger national security.

I remind the committee that in 1974 the Shah of Iran proposed to buy Pan American World Airways. Had Secretary Skinner been calling the shots in 1974, he would have said, well, Iran is our closest ally in that part of the world. There is no national security problem at all. Let the Shah buy Pan American World Airways.

If that had happened, today would our Pan Am's CRAF fleet be parked in military air fields in Iran side-by-side with jets of Iraq?

Mr. Chairman, the fundamental problem that the industry faces and that the public faces is that this is the only public utility in the United States that is not regulated. That is a very extreme thing to say.

Most people don't view the airway system as a public utility. Let me give you the argument that it is.

The public owns the airways, all of the airports and all of the air traffic control system.

That publicly-owned and taxpayer-funded system is worth about a trillion dollars. The replacement value of all the airports and all the air traffic control system together is about a trillion dollars.

The only way the public has access to that system is through the commercial airlines. They are privately-owned. Today you could buy all of the commercial airlines on Wall Street for about $15 billion or the equivalent of one-and-one-half percent of the total public investment in that system.

Yet these private owners, these monopolists, these shared monopolists dictate the destinations, the terms, the conditions of service, and the rates and restrictions under which we fly.

They control the public access to that public system.

It would be the equivalent of deregulating the trucking industry and turning over the interstate highway system to the trucking companies. It would be the equivalent of deregulating the barge companies and turning over the Mississippi River and all the bridges that cross it to the barge owners and allowing them then to determine the tolls that we the public are going to pay to use that system that we own. Then, more recently, allowing them to sell the Mississippi River to the Dutch Government.

Mr. Chairman, that concludes my remarks.

[The prepared statement of Mr. Dempsey appears on p. 281.]

Mr. **Oberstar**. Thank you very much for some very graphic testimony and thoughtful comments.

I couldn't help but thinking Pan Am might have been called—had the transaction you posited taken place—that we might be calling it Ayetollah Airways today.

Mr. Kasper, thank you very much for being with us, for your patience in waiting to testify.

Mr. **Kasper**. Thank you, Mr. Chairman.

I appreciate the opportunity to testify again before this committee.

As the Chairman is aware, I have had the privilege of testifying before this committee previously in several capacities dating back a few years as head of the Bureau of International Aviation at the Civil Aeronautics Board and more recently as the independent aviation analyst in hearings before the Board.

In any event, I do appreciate your invitation and the invitation of the subcommittee to discuss the condition the airline industry and the prospective and perspective state of competition in that industry.

I might say I am delighted to be the wrap-up witness here and appreciate your willingness to put in a long day so shortly after Congress is back in session.

Let me say by way of introduction that my testimony reflects research undertaken for a project sponsored by the American Enterprise Institute as well as analyses undertaken in my role of an independent group of aviation experts that have been informally called the think tank on multilateral aviation liberalization.

I stress I appear on my own behalf and the views I express here have not been reviewed by nor do they reflect the views of Harbridge House, the American Enterprise Institute or any other organization.

Those interested in good financial news would be well-advised to avoid reading the financial reports of major U.S. and foreign air carriers. I notice Mr. Dempsey paints a picture that is occurring only in U.S. industry. I would commend the New York Times which makes it clear the economic impact is being felt in Europe as well—it is being felt very painfully.

I think the distinction between airlines that—in the U.S., which can take advantage of liberal reorganization statutes in saying there aren't such things abroad, frankly, is a red herring.

The point is those airlines are suffering, too, and for much the same reason.

Those reasons you have heard much about today I won't repeat them in any detail. They show the result is an industry that has been adversely and in the case of a few airlines perhaps critically impacted by the effects of sharply higher costs—principally fuel—coupled with a significant softening in demand.

More troubling than the significant operating losses is the fact that several major carriers also appear to be suffering negative cash flows; that is, their revenues are insufficient to cover their current cash obligations. While a negative cash flow is never desirable for an airline, temporary periods of negative cash flow pose no threat to financially sound airlines because their strong cash positions, healthy balance sheets, and access to short-terms lines of credit permit such carriers to ride out periodic financial storms. Indeed, some are even able to acquire assets and otherwise strengthen their competitive positions during such periods.

But several major airlines are not as well-positioned to handle the current turbulence. Some have relied upon LBOs, junk bonds or other forms of highly-leveraged debt to build financial structures, ill-suited for adverse economic conditions. Others have failed to develop and/or execute viable strategies for competing in a deregulated market place. This is particularly true for carriers that, as a result of poor management or bad luck—and it is much of the former and a little of the latter—have been unable or unwilling to develop sizable efficient domestic route networks.

Still other financially-vulnerable carriers have suffered as a result of a failure to develop and maintain positive labor relations. That is a subject you heard about at some length from the preceding panel.

I would add to that discussion that I think it is instructive in the case of Eastern Airlines that the union, particularly the machinists union, has had very difficult labor relations not simply with Mr. Lorenzo or Mr. Chagru, but also Mr. Boorman and, indeed, with Captain Eddie Rickenbacker before that.

I think there is plenty of blame to go around in the demise of Eastern Airlines. I believe in all fairness the unions have to share some of that blame along with ample blame upon the past managements of that carrier.

For these carriers, the prognosis is more guarded. In my estimation, absent an infusion of new equity capital, or a significant decline in fuel prices and a quick rebound in traffic, several will find it necessary to sell significant assets in order to continue operations. For at least one carrier, even asset sales may not be sufficient to ensure its long-term survival.

Over the short to medium term, three factors hold the key to the financial performance of most major airlines:

The duration of the war and the perceived terrorist threat to civil aviation which are adversely affecting airline traffic and revenues;

The length and severity of the recession which also depresses airline demand and revenues;

The price of jet fuel which, until the hostilities began, was by far the most significant factor behind the entire industry's poor performance.

I am well aware of the difficulty in predicting the future performance of airlines even in normal times.

I am hesitant to be specific now. I will say barring a minor miracle, I would expect 1991 to be less than a break-even year and 1992 to be the year in which the industry bounds back financially.

I would now like to turn to the committee's other concern in these hearings: the state of competition in the airline industry.

I think Steven Morrison gave you, in my view, an excellent summation and I find myself in agreement with virtually all of it with one exception which I will note and that I wish to commend to the committee his remarks.

By now this committee has heard and I must say I am pleased to hear the—over the several years I have been testifying before this committee what I believe to be a much heightened level of interest and understanding of the forces—the economic forces operating in the industry, particularly the trend towards globalization.

I believe it is clear now beyond a shadow of a doubt to all but the most myopic observers that the substantial economics of scale and scope that are attainable in a deregulated aviation market place mean the structure of the ax industry today will increasingly be characterized by relatively small number of large single carrier air transportation networks which compete with each other in an expanding number of city pair markets.

Steven Morrison indicated that if you look at the city pairs, which is where competition takes place, you will in fact find there is more competition, not less, than there was in 1978; and if you go back to 1977 or 1976, which I agree is a much better starting point, you will find there is far more competition.

Where it takes place at—in the supermarket it takes place between supermarkets in a local community, not how many chains there are nationwide. In the airline business it takes place between city pairs. There the picture is much more favorable than one would be led to believe looking at the national statistics.

In other words, a reduction in the total number of U.S. airlines in aggregate does not necessarily indicate a reduction in competition.

I refer here in my testimony to the specifics of the city pair numbers that Dr. Morrison already covered.

While I am thus not alarmed by the present state of competition, I am also convinced of the wisdom of the famous American maxim that "The price of liberty is eternal vigilance" and I commend the committee for its willingness to consider whether and how competition can be preserved and strengthened. For I continue to believe that Congress was right when it made clear, in passing the Airline Deregulation Act of 1978, that competition is the best way to protect consumers and the public interest.

But what realistic options does the Federal Government have to alleviate the present financial distress of the industry and enhance competition? If my analysis thus far is correct, there is only a limited amount the Federal Government can or should do in an effort to improve the financial condition of individual carriers or the industry as a whole. Nonetheless, some steps could help.

On the cost side, you have heard testimony the administration released fuel from the SPR. I believe further releases could lead to cost declines. I believe it would be difficult to justify special treatment which benefited airlines but not other users of petroleum products.

For purposes of my testimony, I had made a working assumption that there—the committee would not, because of budgetary reasons, give serious consideration to things which, proposals which substantially affected or prospectively reduced the Federal tax revenues. Therefore, I did not get into the question of reducing or eliminating the ticket tax.

If the committee were prepared to consider a deferral of the additional 2 percent increase, I think that would be a sensible step that would have beneficial effect on the industry and would not, and should not in my view, since it is not yet a tax which is in place, be construed as a subsidy. It would not be a subsidy. Only an executive branch official that is used to having money as a matter of right could construe a tax that isn't in place, taking that off as a subsidy. I don't consider it a subsidy. That would be one that I think would be well worth consideration.

Likewise, I believe the Department of Transportation can and should permit operating airlines to sell international routes—so long as the proposed transfers are subject to a careful competitive review. The principal reason for permitting such sales is that the market is more reliable than administrative law judges and civil servants in allocating routes to carriers that will make the most effective use of them.

Reliance on the market is much more likely to put those scarce route resources into the hands of carriers that can use them most effectively. I stress again, subject to competitive reviews.

In testimony I gave before this committee a year and a half ago, I believe I cited the example of the Braniff-Eastern route acquisition, which was preceded by an attempt by Pan Am to acquire Braniff's South American routes, which would have resulted in giving Pan Am a monopoly of U.S. carrier routes to South America. The board which has the transaction at that point refused to do that and set the case for hearing. In the interval another carrier came in. I believe that that is the type of review that would be appropriate.

I have attached to my testimony an article which elaborates somewhat on the reasons I believe that route sales are more efficient and effective as a way to allocate these resources.

In addition, the Department can and should permit increased foreign investment in U.S. airlines to the extent it can do so consistent with the Federal Aviation Act. Further, I believe that the Congress should give prompt consideration to revising the Act to significantly increase—or eliminate entirely—the limits on foreign ownership of U.S. airlines and to authorize U.S. negotiators to negotiate increased foreign investments and for U.S. carriers to invest abroad.

I would not support grants of antitrust immunity to permit airlines to discuss schedule reductions or price increases, steps taken in the mid-1970s when the first Arab oil embargo took place. Those steps were difficult to justify even in a tightly regulated industry. I believe they would be wholly inappropriate in a deregulated industry.

Finally, I do not believe the Congress or the department should now attempt to reregulate airline services or rates. Aside from the fact that it would be impossible to do so without substantially impairing efficiency and service, I believe that the far wiser course would be to adopt policies that strengthen competition by, among other things, permitting the infusion of foreign equity into U.S. airlines. Because of the potential significance of foreign investment, I would like to address the balance of my remarks to that subject.

I would like to briefly summarize the reasons I believe the committee should consider amending the Federal Aviation Act to permit foreign investment in U.S. airlines.

First of all, it is critical to realize that purchases by foreign airlines of equity interests in U.S. airlines are the result of fundamental economic forces at work in the airline industry, forces that are driving that industry towards a more global structure. Over the next decade, airlines are likely to become more transnational—both in terms of their operations and their ownership structures.

This is true, by the way, listening from testimony today, one could get the impression it was only foreign airlines that wanted to invest in the United States and not U.S. airlines that wanted to invest abroad. That is incorrect. U.S. airlines do want to invest abroad. They recognize in the main that it will be necessary for them to do so because they recognize that in order to compete in the global market, they will need better presence abroad.

The simple truth of the matter is we will not be able to have our carriers invest abroad if foreign carriers cannot invest here. That is the kind of reciprocity that this committee believes important. I agree with you wholeheartedly. That is also the kind of reciprocity foreign governments would consider important as well.

Also, I must stress the airline industry, consumers and labor are likely to benefit from a regime that liberally permits transborder investments in airlines. Indeed, the potential benefits are so substantial, I am convinced that it would be a major mistake for the United States to maintain the barriers to foreign investment in the airline industry contained in the Federal Aviation Act.

These benefits include enhanced competition and the preservation of competitors in domestic airline markets; the latter consideration is particularly applicable to several of the major U.S. carriers now experiencing financial difficulties, as you heard earlier today in the case of several U.S. carriers experiencing financial difficulty.

Let me talk briefly about the national security interests. This is a point that has been raised. U.S. national security interests are not likely to be impaired by foreign investment in U.S. airlines and can be fully protected without restricting foreign investment. The entity the foreign airline or foreign equity invested in would be a corporation incorporated in the United States. Changing the rules on foreign investment would not change the immigration laws of this nation. It would not change its labor laws.

That is to say, the employees and management of the company would still be U.S. citizens. The aircraft, which are the critical aspect that we are in the main talking about here, would be U.S.-registered aircraft. That gives the U.S. government plenty of leverage and the Department and Federal Aviation Administration the leverage to control the use of those aircraft.

Indeed, if the Department ever felt that the voluntary incentives that it now provides for airlines to participate in the CRAF program were insufficient, there is not the slightest doubt that the Congress could make the registration of—U.S.-registered aircraft and the enrollment in the CRAF program mandatory. That would be a step that could easily be taken.

Finally, let me say I think the more difficult problems with the foreign equity investment are ones this committee is obviously hearing the testimony and the give and take this morning acutely aware of. That is the problem of foreign airlines either trying to use the equity investment to get around liberal bilateral agreement—that is to avoid, for example, opening their markets to us by buying into our market.

Therefore, I strongly believe that any equity investment by a foreign carrier should be conditioned—indeed, any foreign national, should be conditioned upon having an open skies agreement with the United States. I was pleased, Congressman Clinger, to hear that that was a major element of your bill.

In a similar vein, I believe U.S. officials must seek to assure that transborder investment in the airline industry is a two-way street, one that can be traveled by U.S. airlines investing abroad as well as by foreign airlines investing here. Our investment restrictions are similar to and in a number of cases stricter than those imposed by our major trading partners.

Finally, I want to stress that the equity investments in one airline by another airline should be subject to careful scrutiny for its probably or potential impact on competition. This is true whether the acquisition involves an equity acquisition or an asset acquisition by a U.S. carrier of another U.S. carrier or a foreign airline in a U.S. carrier.

In other words, the transaction should be subjected to antitrust and competition policy reviews. The invitation or the opening up of foreign investments should not in any way be read or treated as a relaxation of the antitrust laws. That would be a major mistake. It appears the Justice Department is not taking the position that it should.

Both the Justice Department and the Department of Transportation would retain ample authority to deal with these issues.

The last point I would make, Mr. Chairman, is that in considering the issue of nonequity investment we not lose sight of the positive competitive benefits and to think, for example, that carriers in the situation of Pan Am today or Continental might well benefit from the infusion of foreign capital into their operations when it is so obvious that there is simply not enough interest in domestic capital markets to put any additional equity capital into those carriers.

Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Kasper appears on p. 305.]

Mr. **Oberstar**. Thank you, Mr. Kasper, for a very thorough assessment of the condition of the industry and the factors that bear upon investment, growth, and competition.

I was glad to hear you add a condition to your statement about equity investment. I made a marginal note alongside your enthusiasm for expanded equity investment.

Shouldn't we get something in return for opening our airlines to this expanded investment policy? We ought not to just simply give something. It is a very valuable right to invest in U.S. carriers, because as other witnesses—including those at this table—said, I think you yourself acknowledged, that when a foreign airline will invest in a U.S. carrier, especially under current conditions in the industry, they are not just looking for a percentage rate of return on the dollar they have invested. They are looking for something much bigger.

So we ought not to let ourselves be chewed up piecemeal; we ought to negotiate such matters in the broad context of our aviation interest with whatever airline and its national government is interested in that investment in the U.S.

If the industry somehow is reduced down to three or four or five major carriers, are those carriers likely to compete vigorously, whether it is city pair or hub to hub, or will each carrier simply refrain from putting in place resources necessary to challenge another at a hub or in a particular geographical area? Just hunker down and nurture their own market?

For example, why would another carrier—U.S. or foreign—come into Minneapolis-St. Paul, challenge Northwest Airlines by putting in a computer reservation system in there, at a cost of developing affiliated carriers to serve the large geographical area for which Northwest draws to serve its hub at Minneapolis-St. Paul, and put in place the support system needed to attract the customers?

Why would they go to all that expense? Wouldn't it be simpler just to say all right, Northwest, that is your territory, you go ahead and run it; TWA, that is your territory, you run it down there in St. Louis; so forth around the country, except for a few areas where the market is so big that you really will have some competition?

Mr. **Kasper**. Mr. Chairman, if I might start with that, first of all, I think you touch on a very sensitive issue. I agree, I think most economists would agree that even though the number of carriers competing in individual markets has increased, obviously the smaller the number of players—Steve Morrison said there is a greater risk of collusion, either explicit or implicit. I think that is something that one always needs to be alert to.

Having said that, however, I so far see absolutely no evidence of carriers taking a hands-off position on anybody, at markets people may consider theirs or traffic people may consider theirs.

I think your assumption, or what I take was the point behind your question, would some other carrier come in and set up a competing hub on top of Northwest's hub in Minneapolis, I think given the size of the local market and the feed markets through there, the answer to that is almost certainly no.

It is much more likely to see what you have now, which is carriers competing for the westbound traffic that flows from the same catchment area through hubs in Denver, Salt Lake City, and possibly even as far south as Dallas and eastbound through a number of hubs, including Chicago, St. Louis, and so forth.

So I think that just the economics of operating a hub, you are not going to get very many multicarrier hubs. Most passengers are traveling on flights where they have multiply choices of carriers on either a one-stop or connecting basis. So there are ample competitive opportunities there.

Mr. **Oberstar**. Dr. Morrison?

Dr. **Morrison**. Yes. You ask why would a carrier choose to compete rather than take—live the easy life and cartelize the industry.

I think the answer to that is the profit motive. Even though a cartel would have monopoly profits, there is always somebody that is greedier than their share of the cartel's profits.

Cartels are notoriously unstable, especially when they are illegal. That is one of the reasons industries seek government protection from competition, in order to legalize the cartel, so cheating becomes monitored by the government rather than implicitly monitored by the competitors.

Also, what the future holds, of course, is a big question mark. We can look to the past to get some hints. A study I have done looked at entry and exit behavior of airlines. Why do airlines enter or what factors influence the markets they do enter. We found in the first few years of deregulation, airlines stayed away from other carrier's hubs. They didn't want to enter a city-pair market that involved somebody else's hub.

That fear of entering—not entering a whole hub, which is another matter, but just entering a spoke to somebody else's hub, that reticence to take on another carrier at their hub on a route basis is much diminished so it practically isn't there anymore.

Also, I recently read a paper I had nothing to do with writing. I read it. It attempted to look at United and American's behavior—what it did look at, their behavior on the routes only they compete expecting or asking the question, just this question: If you are only competing with the same carrier on 30, 40 different routes, are you likely to see the higher monopoly or cartel-type prices? They found no evidence of cartel-monopoly pricing on those 30-some-odd routes they analyzed where United and American compete head to head.

Also, on the subject of hubs, they clearly are, as everybody indicated, a controversial issue. I mentioned in my testimony that measurement is a key. All studies find that fares are higher at hubs. The industry claims that that is because there is more business travel at hubs. To my knowledge, nobody, including the airline industry, has documented this. It could be a reasonable point.

But the measure of concentration typical at hubs, percent of flights, will of course be biased, or percent of gates or percent of total enplaning passengers will be biased in favor of a high concentration of the hub and carrier. The fact they have a hub there means they will have a high fraction by all those measures.

If you look at the level of competition on routes for origin-destination traffic originating or destined for the hubs, you get a much different picture, not so much as the numbers. There still—in Pittsburgh, that is one I looked at when preparing my testimony—a dramatic increase in the percentage of enplanements for USAir, but a very small increase in USAir's share of originating traffic. They have a high share because they are a hub. Fares are higher.

What one can do about it—people suggested fare caps at hubs. I think that fare caps could by definition keep fares from going the 27 percent that GAO finds. I find something lower. They could keep fares from going too high. But there would be a cost for that. I don't think that can be discounted. If profits from hub operations are reduced, hub operations will be less—there will be fewer hub operations.

I think the hub and spoke—some people call it the hub and choke—hub and spoke is an innovation that is quite valuable to the industry.

Mr. OBERSTAR. I suspect if any of us who were sitting in this committee room in 1978 had any idea that hub and spoke would be the immediate product of deregulation, it would not have passed this committee in the form in which it did.

Dr. MORRISON. I will take your word for that.

Hubs provide competition. They provide—the tradeoff you get is some people get higher fares. We get increased service frequency especially to smaller communities.

Mr. OBERSTAR. They also instituted industry monopoly of entry and fares for government regulation thereafter.

Mr. Dempsey?

Mr. DEMPSEY. Mr. Chairman, just on the point of hub and spoke. The inherent advantage of air transportation as a means of moving anything in this country is its speed. It is twice as fast as any other mode of transportation. It is unencumbered by rivers, mountains, or any sort of natural barriers. The only thing that slows it down is hub and spoke operations. I would argue it is a drag on American productivity, because it consumes people's time.

But to the question you posed to the panel, Mr. Kasper said he saw no evidence of a hands-off position. I have seen a couple of pieces of evidence of collusion. One was a telephone conversation between Mr. Putnam and Mr. Crandall which was embarrassing for Mr. Crandall. Mr. Putnam turned it over to the Justice Department. Mr. Crandall suggested to Mr. Putnam, the CEO of Braniff, that they raise their fares 10 percent, pointing out Delta and Eastern have been doing it for years in Atlanta.

The other part of your question had to do with new entry. The fact of the matter is that the infrastructure has been consumed. The gates—more than 80 percent of the airlines are under long-term lease for more than 30 years. The landing slots have all been bought up at the slot-controlled airports.

There are problems with computer reservation systems. You heard a lot about that. You heard some things about frequent flier programs. Nobody has talked much about commission overrides. Those are problems, too. Labor costs. The lack of investor confidence, the knowledge that incumbents will not sit idly by.

One of the dimensions of the CRS that nobody talked about is the fact they facilitate implicit price collusion. They assist an instantaneous exchange of information. You can ask your competitor through the CRS if he will follow your fare up or find out if he will follow it down very quickly.

We have the phenomenon of FU fares that the press has talked about where carriers punish other carriers for not adhering to the gentlemen's club of not competing too vigorously.

The smaller the number of airlines undoubtedly the more opportunities for implicit or explicit price collusion will be; and the likelihood of antitrust scrutiny I think is remote.

Mr. OBERSTAR. The hub and spoke is certainly a brilliant invention and a good example of how industry can quickly move in an unfettered—but again, I question whether we have more or less competition if we go the route of broader foreign investment and have further deterioration in the number of carriers.

Mr. KASPER. Mr. Chairman, you have asked several times today a very important question. You have given an answer which I think is the right answer, which is this foreign airlines investing in the U.S. are looking for more than a passive investment. I think the reason why foreign airlines are willing to pay more than U.S. investors are willing to pay is because they recognize that there are synergies or potential synergies between the system. I think what we are looking at is—I suspect if foreign carriers come in, if the change in policy is sufficiently attractive, foreign carriers will look at this as an opportunity to become part, to add an important part to a network.

They recognize, as U.S. carriers recognize, that if you are going to be a global carrier, you have to have a presence in the major markets of the world. We are a major market. The European Community is a major market. Asia is a major market. All of the carriers are struggling to get positions in all of those markets.

I think the answer is yes, they are looking for something there. They are looking for synergies. I think that that is a plus if properly treated, because what it means is that carriers that couldn't survive independently in the United States because they simply don't have the financial strength to compete playing only in the U.S. market and relying only on their own resources against carriers that have been more successful, this gives them a chance to become part of a larger network that will help maintain and strengthen competition in this market and at the same time expand competition internationally.

So the comments about reciprocity still stand. You have asked the right question. I think the answer is yes, they are looking for something. That is going—that is what they are looking for.

Mr. OBERSTAR. Thank you very much.

At this point I must ask Mr. Parker to assume the Chair and continue the questions. I do have another obligation temporarily.

Mr. PARKER [presiding]. Mr. Dempsey, do you want to add something?

Mr. DEMPSEY. One point about reciprocity. If we ever get in the business of exchanging cabotage rights, recognize there are not reciprocal opportunities abroad. If we want to exchange them with Holland, there is not much opportunity in flying between Amsterdam and Rotterdam for U.S. carriers. If we want to get in the exchange of cabotage rights with the European Community after 1992, recognize the capacity constraints of the European airports are even worse than they are in the United States. The opportunities for real entry are not the same.

Mr. PARKER. Let me bring up one thing. Deregulation, if it is done properly, is not destructive. Deregulation when it is done improperly is destructive. I think I personally feel some of the things that have been done have been extremely destructive. Because of deregulation and it being done improperly, we are reaping the benefits of people not being able to see the long view and know exactly what is going on.

Dr. Morrison, you have studied why people fly and why they go into areas and how the competition works. Have you done anything as far as landing fees? A lot of these rural airports have little leeway as far as raising money. One of the things they do have is a landing fee. Have you done anything as far as that?

Dr. MORRISON. I have done a fair bit of work on landing fees, not so much with the focus on the uncongested rural airports. Most of my work is on congested urban airports.

Mr. PARKER. Would there be an effect as to the type of aircraft a carrier would put into a rural airport? If the landing fee was at a certain level, they would not put in larger aircraft? Using a twin-engine prop to come in?

Dr. MORRISON. I think there would be a margin where they would change their mind. Typically landing fees are so small—I think 2 percent on average—in general it wouldn't make that much of a difference. Clearly, if they were high enough and there was a margin, they decided to go from a larger airplane to a smaller plane, assuming it is a weight-based landing fee. At the very small airports where smaller planes are attracted, there are few fees or a per landing charge rather than a weight-based landing charge.

Mr. PARKER. Mr. Kasper, what is your reaction to Mr. Dempsey's assertion that airways and the airline industry itself, as far as the amount of money that the Federal Government and state governments and local governments put into it, could be classified as a public utility?

Mr. KASPER. A, I am not surprised. I heard him make the statement before.

B, I think it is wrong.

You could say the same thing about the trucking industry using the interstate highway system or the public roads system. It is a roadway system built by the taxpayers and some combination of user fees, as are the airways. So I think that it is certainly accurate to say that there are major investments in airways and airports, but that does not lead in my view to a conclusion that the operation of air services should be treated as a public utility. I don't believe that is the case.

In fact, I believe there are some areas in which it would be advantageous to look at moving some aspects of the infrastructure out of the public sector and to try to reduce the cost and increase the quality of the services there.

Mr. PARKER. In the spoke and hub environment, you make the statement that competition occurs and you see competition occurring in the city pairs, going from one city to the next out of a specific location. That is where competition occurs. You make the statement from the standpoint of that is good because we have competition there.

What do you say in response to a statement when it goes a little further than that, saying sure, there is competition between those two carriers, whomever they may be, but nobody else can get in? The entrepreneur who would like to get involved and start a business, all of a sudden is left out of that market. That stifles competition, that doesn't increase it.

Evidently, you may be talking about a different type of competition than I am. Explain that to me.

Mr. KASPER. I would be happy to. I think your point about entrepreneurs is a good one. First of all, my testimony, and in much more detail in Steve Morrison's, it indicates there are more carriers, if you look at the individual city pair, the average number of carriers competing is up. That shows an increase in competition by the way most economists would measure it.

If the question is can others get in, if the answer to that question is no, then I think one has to ask a couple more questions. Such as, why can't they get in? It seems to me that you can break out, roughly speaking, the causes into two sorts of causes: those that I will say result from the natural operation of economic forces, and those which are artificial in the sense that they are barriers that result—have been created or resulted from some other actions. And I think there are a number of those here that this committee should be very concerned about, because frankly many of the barriers that are here are barriers the Federal Government has had a major hand either in creating or not taking down.

Let's take the example of slots. If you listened to a lot of the discussion about slots, somehow or other you get the impression that the problem with slots is the airlines are monopolizing them. Well, there may be—if airlines are indeed monopolizing them, that could indeed be a problem. If you look behind it, the fundamental problem is that—the unwillingness or inability of this government to address the capacity issue, to build more airport capacity, and to permit the existing capacity to be priced in a way by the airports through landing fees that would tend to generate revenues and relieve some of the congestion.

That is one area.

A second area where the Federal policy has had some marginal effect on the viability of new entrant carriers has been touched on in the question of frequent flier programs. Frequent flier programs I think are interesting devices. It is a marketing device that was created to build customer loyalty. There is nothing wrong with that. Where it is a little unusual is that most of the frequent flier miles are accrued by business travelers who do not pay for their travel and who can then collect the frequent flier miles as a personal benefit tax free.

In other words, the tax system is making it advantageous to operate a frequent flier program. It is being paid for.

I cash in frequent flier bonus miles. I get business travel. I get those. That is a personal nontaxable benefit to me. If the Congress were serious about it and the administration were serious about dealing with it, it would look at how one might impose taxes on that.

Mr. PARKER. You are talking to the largest group of frequent fliers in the country, the Congress.

Mr. KASPER. That is—in fact, wags have been quoted as saying that is exactly why the Congress will never touch it.

Finally, I would like to say a little bit on the question of CRS. I know that is a subject this committee is very interested in. That is a question of a barrier as well.

Obviously, these systems have been constructed not by government but by carriers who saw a commercial advantage in doing that and saw that it would be immensely helpful in distributing their travel products through travel agents to the traveling public.

Mr. **Parker**. Do you not agree that it is also true that the computers—the computers themselves and the ability to crunch those numbers quickly and be able to give different figures quickly, that computers have also allowed one airline to target another airline or a part of that airline to move business away from it? It is the simple fact that the computer can do that.

If you did not have computers where an individual would have to sit and calculate, first of all, you would not have as many prices. You wouldn't have that many fares. There are so many different fares each airline has between point A and point B, according to how you can meet the criteria, if you call at the right time, if your hair is brown, if you have hair.

Mr. **Dempsey**. There are between 40,000 and 60,000 fare changes a day.

Mr. **Parker**. Computers allow that. That has to be considered whenever you are talking about the CRS?

Mr. **Kasper**. There is absolutely no doubt that computer systems, whether they be computer reservation systems or whether they are internal systems such as yield management and inventory management systems, have been immensely useful, powerful tools for airlines to do all kinds of things that they would find difficult or impossible, or perhaps too expensive would be more accurate, for them to do without those computers.

But if you are worried about fares, the evidence that Steve has given on what has happened to yields is very consistent with my own analysis that yields have remained essentially flat, if you put them in real terms may have gone down slightly since 1978.

The fact there are lots of fares out there is not bad. That—I mean, if you look at that in the context of what has happened to prices, one would have to say this is providing a variety of products for the customers.

Mr. **Parker**. Understand also—if you had been here during the day listening to the testimony—I have repeated time after time. This is a transition period. We are not at the end of deregulation. Where we are going to see the full result of deregulation in 10, 15 years from now. Then we are going to be put in a box. We may be in a situation we can't get out of because we will have a certain number of major carriers. The Secretary of Transportation told us he thought there might be up to seven but more than three. This is a problem we may have then.

One other question.

You made the statement on the foreign ownership. Whenever you deal with a foreign corporation, with a domestic corporation, there is—you know, we can sit back and discuss the point you brought up, a lot of these foreign carriers are—we don't own any airlines, our nation doesn't. A lot of these foreign countries own part or all of their airlines.

Now how do you view that? You do not mention, you do not talk about that in your statement. How do you view—I mean, it seems like it should be—it is almost a treaty, because you are dealing with a foreign government and you have got a domestic corporation that is dealing with—maybe we ought to get the Senate to approve it or something.

We are talking about an entirely different ballgame when we talk about a subsidized partly foreign-owned airline coming in and buying our—and I am talking about government-owned—coming in and buying part of our market. Even if there is reciprocity, it is not government with government. It winds up being a domestic corporation with a foreign government.

Explain that.

Mr. **Kasper**. You are right to point out the problem, as Mr. Dempsey did that, the—when you are talking about reciprocity, you have to consider not only investment rules but also what one can invest in abroad. I would say that I think that that is an important consideration, that in considering whether or not to grant a foreign equity investment, that should be a factor to be considered.

You know, I think there are vast differences in the type of ownership that foreign governments have in their airlines, and indeed I think if you look at what is happening in the airline industry, you will see that there is a significant trend in the direction of privatization of those airlines. British Airways has been mentioned; Japan Airlines, which was one of the world's largest airlines, has been privatized. There are serious discussions underway about privatizing Lufthansa and a number of airlines around the world.

I think that is certainly one factor that would have to be considered. I would also say that just because a government owns some interest in a carrier would not necessarily rule out reciprocity either, in my view. I think that again is something you have to look at on almost a case-by-case basis. It is something you would have to consider.

Mr. **Parker**. Gentlemen, we appreciate your testimony.

The committee appreciates your patience in sitting through a lot of slowness of the day. I thank you very much.

This committee is in recess until tomorrow morning at 9:30.

[Whereupon, at 6:40 p.m., the committee was adjourned, to be reconvened at 9:30 a.m., Wednesday, February 6, 1991.]

[illegible] that's dealing with, maybe we ought [illegible] the Senate [illegible]
[illegible] something.

[illegible] would be an entirely different [illegible] when we talk about [illegible]

[illegible]

[illegible] with a foreign government.

[illegible]

PREPARED STATEMENTS OF WITNESSES

STATEMENT OF

Captain Randolph Babbitt, President

Air Line Pilots Association, International and
Vice President, Transportation Trades Department, AFL-CIO

Before the
Subcommittee on Aviation
Committee on Public Works and Transportation

U.S. House of Representatives
February 5, 1991

The Financial Condition of the Airline Industry and The Adequacy of Competition

Good morning. I am Randolph Babbitt, the President of the Air Line Pilots Association, International (ALPA). ALPA, which represents over 42,000 pilots at 51 airlines, appreciates the invitation to appear before this subcommittee today to present its views on what actions Congress might take in light of the current financial state of the airline industry. I am also testifying today in my capacity as the Vice President of the Transportation Trades Department of the AFL-CIO, which is composed of 25 affiliated unions representing millions of workers.

These hearings could hardly be more timely.

41-650 O - 91 - 6

The airline industry is obviously in a state of crisis. Industry experts project 1990 losses to exceed $2 billion, nearly three times the previous record loss of nearly $700 million in 1982. For the fourth quarter alone, losses will likely reach $1.5 billion.

Currently one-fifth of industry capacity is under the protection of the U.S. Bankruptcy Code. Eastern Air Lines, which filed a bankruptcy petition in March 1989, ceased operation last month. Continental Airlines and Pan American World Airways, which together represented 15.3 percent of industry capacity in 1990, have filed within the past two months. Several other carriers are in extreme financial difficulty, but to date have avoided seeking bankruptcy protection.

Although the size of the expected loss for 1990 is a staggering figure, it does not reflect the extent of the industry's weakness because it includes sizable gains the airlines have recorded from the sale of assets such as the sale-leasebacks of aircraft and the disposition of gates and international route authority. In the first three quarters alone, this figure approached $1 billion, making the underlying loss for 1990 closer to $3 billion. The financial picture is currently becoming more critical as some airlines have few, if any, remaining assets to sell.

Employees also have paid a price for this downturn. Nearly 10,000 employees have been laid off by U.S. carriers since January 1990. This figure does not include a second round of furloughs at USAir, which expects to pare its capacity by an additional five percent before May of this year. Nor does it include the nearly 18,000 employees at Eastern who have lost their jobs. Employees at Hawaiian Airlines recently agreed to reduce pay by ten percent as part of a larger plan to rescue that airline.

What factors have contributed to this financial crisis? First and foremost is the sharp rise in fuel prices following Iraq's invasion of Kuwait. Uncertainty, not a shortage of oil, pushed crude prices to a peak of $40 per barrel by early October. Such jitters added nearly $2 billion to the industry's fuel bill in the fourth quarter alone.

Second, a slumping economy has put increased pressure on this cyclical industry. The domestic industry, sluggish since 1988, has seen fares under downward pressure from struggling carriers such as Eastern, which slashed prices below costs in a desperate attempt to fill seats. The sharp drop in GNP in the fourth quarter, combined with limited success in raising fares to offset increases in fuel prices, caused the domestic market to shrink towards the end of 1990. The industry's ability to raise fares was also dampened by a 25 percent hike in the federal U.S. transportation tax from eight to ten percent of the price of a ticket. The higher ticket tax would have added over $1 billion to ticket prices in 1990.

A third factor is the war in the Gulf. The war has exacerbated the industry's financial problems because of traveler concern over terrorism. Several major U.S. companies have cut back on both international and domestic travel. Some of those who are flying are booking away from U.S. flag carriers because of the fear of terrorism. The net impact has been devastating. Airlines have been canceling flights and still are flying near-empty planes. Despite the recent decline in jet fuel prices, the fall off in ridership may well make the first quarter of 1991 the worst quarter on record.

Fourth, the airline industry was not spared from the LBO trend which swept corporate America in the 1980s. LBOs have burdened several airlines with debt with no constructive purpose other than to make money for investors. A capital-intensive industry such as this cannot effectively compete with such unproductive liabilities. The consequences of the leveraged buyouts that occurred at TWA in 1987 and at Northwest in 1989 are instructive in this regard.

When Mr. Icahn took TWA private through a leveraged buyout, he burdened TWA with over $1.3 billion in debt and $400 million in annual interest charges. To pay this interest bill, TWA's revenue must exceed expenses by over eight percent per year, year in, year out, in good times and bad. This is an average profit level that even the most viable airlines strive for; for TWA, it is pure fantasy. The result -- TWA has resorted to selling international routes and threatening its pilots, whose wage concessions have already made them one of the lowest paid groups in the industry, with further asset sales unless they accept additional concessions.

At Northwest the airline and its parent, Wings Holdings, have used considerable resources to pay back a sizable portion of the debt incurred in its LBO, delaying a much-needed service-enhancement program. Unfortunately, some of the LBO debt has merely been replaced. Even with the buydown of debt, interest as a percent of revenue for the holding company is double the industry average. This debt burden left the carrier strapped for cash and unable to take steps it wanted for expansion. Indeed, until the DOT permitted greater foreign investment in Northwest, the airline's future viability was problematic.

The fifth factor that has contributed to the current financial crisis is deregulation itself. ALPA was an outspoken opponent of deregulation. We find little pleasure in having correctly predicted the dire consequences of deregulation -- from financial turmoil and bankruptcies to contract degradation and job loss.

In a recent speech, Secretary of Transportation Samuel Skinner characterized deregulation as a "stunning success" and stated that "it is time to declare the deregulation debate over." We respectfully but forcefully disagree with the Secretary on both points. Dozens of airline bankruptcies, a deterioration of service quality and tens of thousands of jobs lost, just to name a few of the consequences of deregulation, do not add up to a "stunning success." The lower fares that followed deregulation came at a high price, and now even that benefit may evaporate as real fares have nearly returned to their pre-deregulation levels and are rising.

Having said that, however, ALPA is not here to recommend reregulation. What we do recommend is that, rather than closing the book on deregulation, we take a closer look at deregulation and review what lessons can be learned from a decade of experience. ALPA believes that, after completing such a review, any objective observer would identify one major flaw in deregulation -- its implementation.

A litany of serious mistakes and misguided decisions could be addressed. However, I believe a look at how three financially crippled carriers got where they are aptly makes our point.

The first is my airline -- Eastern. Following its acquisition of the carrier, Texas Air Corporation began systematically stripping valuable assets -- from a computer reservations system to airport gates -- from an airline that was finally, with the help of major wage concessions from its pilots and flight attendants, turning the corner toward profitability. Confronted by a call in a pending congressional resolution for a full investigation of the asset-stripping scheme, the DOT preempted the resolution by undertaking a preliminary inquiry into whether the scheme warranted a full fitness investigation. In our opinion, the outcome of the inquiry was predetermined when, in a remarkable example of illogic, the investigating team was instructed not to find Eastern's fitness undermined as long as the asset transfers, even if detrimental to Eastern, were beneficial to Texas Air or its other subsidiaries. Two years later a bankruptcy-court-appointed examiner, following an extensive review, concluded that there were grounds to assert that many of the transactions that were of no concern to the DOT were fraudulent and had caused as much as $400 million in damage to Eastern.

Once Eastern was in bankruptcy, the DOT again missed an opportunity to assist the carrier when it opposed a recommendation of the National Mediation Board that a Presidential Emergency Board be appointed to make recommendations on how the costly machinists strike against the carrier could be ended. It was the first time in history that the NMB's recommendation of a Presidential Emergency Board had been rejected.

The second airline is Pan American. For over four decades prior to deregulation, Pan Am was the premier U.S. flag airline, dominating both the Atlantic and Pacific Oceans and having extensive service to Latin America. It also served many major domestic markets, but was not permitted to develop a domestic hub. When deregulation occurred, the DOT began to allocate new international routes, not to the dominant flag carriers such as

Pan Am, but to airlines with strong regional gateway presence. As new competitors, both domestic and foreign, were allowed to flood into Pan American's markets, the airline began to suffer massive financial losses. Without a plan by the DOT to assist Pan Am in building domestic feed, the airline was virtually condemned to flounder through the decade, selling off most of its assets to fund these sizable losses, all the while impairing U.S. carrier competitiveness and reducing U.S. market share on international routes.

The final carrier is TWA, which I mentioned earlier. In 1987, Mr. Carl Icahn proposed to take TWA private in a leveraged buyout. Upon learning of Mr. Icahn's plans, the Independent Federation of Flight Attendants (IFFA), which represents TWA's flight attendants, petitioned the DOT to initiate an investigation of the effect the LBO would have on the carrier's fitness. ALPA supported the petition. IFFA and ALPA asserted, among other things, that the buyout was a "recipe for TWA's financial disaster" that would strip TWA of most of its liquid assets, increase the carrier's debt load to more than $2.6 billion, and burden it with interest payments almost double TWA's 1987 operating earnings. The DOT, however, denied the petition, finding that TWA had "established a trend of profitability" and that given this profitability and the carrier's "strong cash position" no fitness review was warranted.

Unfortunately, IFFA's and ALPA's predictions turned out to be accurate. The leveraged buyout, while proving quite beneficial to Mr. Icahn, has devastated the airline. In 1989 and 1990 the carrier posted massive losses, in large part because of the additional interest payments required by the LBO, and has proceeded to sell assets, including its valuable international route rights, to fund the losses. To date the DOT has made no effort to stop the dismemberment of the airline.

The recent hasty decision of the DOT to invite additional foreign investment makes it appear that the department lacks a plan for the industry. The only apparent plan seems to be one of giving the airlines what they ask for. The S&L crisis should be a grim reminder of what can happen to a vital industry when it is left to its own devices.

Before discussing what ALPA believes Congress can do to promote the financial health of U.S. carriers, I must respond to some rather serious and erroneous statements made by Secretary Skinner regarding labor; specifically, those that insinuate that employee wages are somehow a cause of the industry's financial problems. The suggestion that wages should fall to the lowest common denominator has little merit. The wage imbalance cited by the Secretary is simply a predictable result of deregulation. Not surprisingly, in an unregulated market the airlines which have earned greater profits have been willing and able to pay more. Indeed, there seems to be little connection between low wages and financial health. It is the carriers with relatively high pay scales that are the most financially sound.

Moreover, airline employees have consistently given wage concessions where the carriers have demonstrated a genuine need for reduced wages and a plan to turn the company around. Pay concessions by pilots, for example, have frequently exceeded ten percent.

Examples abound. Western and Republic were just two of a number of success stories where pilots accepted large pay cuts as part of overall strategies that helped to revive the airlines, making them attractive enough to be acquired by larger carriers.

Are airline wages out of control? Ask the Eastern pilots, many of whom prior to bankruptcy were earning less than they were in 1981. Ask the TWA pilots who are earning 20 percent less in real dollars than they were four years ago. Ask the United pilots, who have had only one four percent across-the-board pay increase since 1987. Nearly all airline contracts have been outstripped by the rate of inflation over the last decade. Moreover, labor groups have typically had to give concessions just to obtain across-the-board pay increases that are commonplace in most other industries. In real dollar terms, the average airline pilot earns less than he or she did ten years ago, and many earn less even in nominal terms than they did several years ago. In addition, there have been significant improvements in pilot productivity over the same period. I would be happy to provide an airline-by-airline review of salaries and productivity.

Despite Secretary Skinner's contentions to the contrary, the Railway Labor Act has worked as a stabilizing factor to prevent disruptions to rail and air commerce, not cause them. The Act's primary explicit purpose is "to avoid any interruption to commerce or to the operation of any carrier." It also provides "for prompt disposition of disputes between carriers and their employees." The National Mediation Board, the federal agency with responsibility for administering the Railway Labor Act, has been very successful in achieving its mission. In over 99 percent of their cases in 1990, the disputes have been settled with no interruption of rail or air commerce.

Mr. Skinner's predisposition to seek quick solutions to complex problems is never more apparent than here, where his fix for so-called high labor costs is to repeal or radically change effective legislation that has been accomplishing its mission.

Perhaps Mr. Skinner does not know how often the NMB has accelerated the bargaining process because of the needs of the parties, especially the financial condition of a carrier such as Pan American in 1989 or Eastern in 1985. Perhaps Mr. Skinner does not know how well the parties believe the Act has worked in practice.

There is little reason to believe that removing the airline industry from under the RLA would improve the financial condition of the carrier or create a more competitive environment. Rather, it could well create instability, generate more carrier failures, and unleash untold negative consequences for many of the 500,000 employees in the industry today. Without the Board's understanding and careful administration of the collective bargaining process, the Secretary's approach could lead to the multi-carrier strikes of the 1960s, the need for more government intervention, and the prospect of crippling industry-wide disruptions.

When considering what steps to take to promote the competitive viability of U.S. carriers, Congress must try to assess what forces will bear on the industry in the years ahead. ALPA believes that "globalization" will be the dominant force in shaping the industry over the next decade. Indications of the importance of international operations have already become apparent. In the last half of the 1980s, international revenue for U.S. airlines grew by nearly 15 percent per year, over double the rate of domestic growth. This growth will be even more important with the domestic industry on the verge of shrinking. International operations also contribute significantly to the bottom line. For example, in 1989 United derived one-fifth of its revenue and over one-third of its operating profit from its Pacific operations. The current feeding frenzy with respect to international route authority is indicative of the importance U.S. airlines place on being best positioned for such growth.

1991 is quickly becoming a watershed year for international aviation. Current issues include the recent change in the DOT policy on foreign ownership, numerous international route sales, negotiations with the U.K. regarding access to Heathrow Airport, and the upcoming Canadian bilaterals that will, in Secretary Skinner's words, "serve as an important crucible for the testing of the cabotage proposition."

The key question is: Will the U.S. government -- through its actions and policy decisions -- pursue a plan to preserve U.S. airline viability and enhance competition, or will it rush headlong into globalization like it did deregulation and risk further damage to such a vital industry?

The issue of foreign ownership has been grabbing headlines over the past few years. The Federal Aviation Act restricts foreign ownership of voting stock in U.S. airlines to 25 percent, limits the number of board seats and corporate positions foreign citizens can hold, and prohibits foreign citizens from exercising control over U.S. airlines. The Act is not designed to prevent airlines from obtaining access to foreign capital markets. ALPA fully recognizes that some of our own airlines could benefit from injections of foreign capital. We do question, however, whether foreign investment in and of itself is going to be the cure-all for financially ailing airlines, and believe that there are several reasons why foreign control has been, and should continue to be, prohibited.

First, the Gulf war illustrates a very real need to protect national security interests. A large portion of the military goods and personnel transported to the Gulf were carried by commercial airlines voluntarily provided by U.S. airlines under the Civil Reserve Air Fleet (CRAF). Foreign ownership raises some important questions about the continued availability of CRAF service.

Second, transportation is a vital sector of the U.S. economy, comprising almost 18 percent of GNP. This industry is an integral part of the transportation system. If foreign control were permitted, valuable assets and resources could be diverted from U.S. to foreign airlines, potentially crippling our industry.

Third, and more broadly, the prospect of foreign ownership raises the haunting specter of other American industries that have shrunk or vanished from the scene because we sold or threw away our technological lead in those areas. The U.S. market is the largest aviation market in the free world and U.S. carriers have a distinct competitive advantage over their foreign counterparts in many areas. Do we really want to hand over another of American industry's crown jewels to the Pacific Rim countries or to a European cartel?

It is in this context that we look at the recent hasty DOT decision to permit KLM to acquire up to 49 percent of the equity in Northwest Airlines. The response by the Association of International Investment -- which favors the lowering of foreign investment barriers -- to Secretary Skinner's announcement of the decision sums up our view of this matter: "What foreign owner would put up 49 percent equity into a domestic airline without control?" The DOT is either naive or hypocritical if it thinks that a foreign investor is going to pour hundreds of millions of dollars into an airline without exercising control to protect its investment.

The ultimate contradiction in the DOT's decision was not that it decided to raise the equity limit. Rather, it was that the DOT removed the administrative oversight that could have ensured that, now that the investment is actually in the hands of KLM, the equity holding could not be used to control Northwest in the future.

The other "miracle cure" being touted as a fix for the various ill effects of deregulation is cabotage. This question of whether the United States should permit foreign carriers to engage in cabotage operations may be posed in the upcoming U.S.-Canada bilateral negotiations. The Canadian government has informed our administration that cabotage will be on their agenda. For the first time, the U.S. representatives have agreed to entertain discussions on this issue. The negotiations are scheduled to commence next month.

The likely outcome of granting cabotage rights would be foreign airlines entering our largest, most attractive routes -- most of which already have extensive service by U.S. airlines. In a stagnant domestic industry with many mature markets, this "cream skimming" would have the net effect of taking passengers off U.S. airlines and putting them on foreign airlines. They win. We lose.

Cabotage is prohibited by the Federal Aviation Act. If the statute is amended to permit cabotage, Article VII of the Chicago Convention -- to which the U.S. is a signatory -- prohibits the granting of cabotage on an exclusive basis. Thus granting cabotage would set a precedent to be observed in all future bilateral negotiations.

Now, if you ask our aviation negotiators about this precedent, they would tell you that if cabotage is given to one country, other countries can ask for it, but the U.S. does not have to give it to them. But ALPA has had enough experience with pattern bargaining to assure you that such a strategy will not work. The U.S. cannot give cabotage to one country without all other countries making cabotage a deal breaker in future bilateral negotiations. The outcome will be no different than when B scales were first introduced to the airline industry. Once the first B scale crept into a contract, every airline made it its number one priority. B scales eventually became commonplace.

Finally, there are a variety of other items which need to be factored into the globalization equation. One is the issue of government ownership of many foreign airlines. Can U.S. carriers be expected to compete with foreign airlines that have either the implicit or explicit financial backing of their government? Another is the granting of additional rights -- such as expanded ownership provisions -- to foreign carriers outside of bilateral agreements. On the KLM-Northwest issue, why didn't the U.S. government even attempt to condition its decision on obtaining from the Netherlands rights to permit U.S. airlines to obtain similar equity stakes in Dutch flag airlines?

With respect to what Congress might do to promote the financial health of U.S. carriers, ALPA has six suggestions.

The first suggestion is directed at what we all hope will be a short-term problem -- the possibility that fuel prices may again surge dramatically because of events in the Gulf. The government should develop a plan to ensure the stabilization of oil prices during the conflict. The airline industry cannot go through another quarter like the fourth quarter of 1990. The Federal Reserve Board, the Securities and Exchange Commission, and other financial institutions intervene when necessary to calm jittery financial markets. We believe the U.S. government should do the same in the oil markets. For the short term, it is doing just that. The President has committed to release 1.2 million barrels of oil per day through February 17. ALPA believes, however, that this commitment should be extended as long as the conflict in the Persian Gulf continues.

Second, the government should pursue other fiscal policies to shore up airline cash flow and improve the industry's deplorable financial condition. Specifically, Congress should waive the additional two percent ticket tax. The higher tax has had the effect of further depressing an already weak passenger base. Such a rollback should continue at least until the conclusion of the Persian Gulf war, and possibly longer, depending on the ongoing financial health of the industry. If the industry is able to fully recoup these reductions by holding the line on fares, the benefit could exceed $1 billion per year. Moreover, a further reduction of the ticket tax for a short period should also be explored.

Third, Congress should amend Section 401(h) to prohibit route sales that undermine the financial viability of an airline. The need for such an amendment is made painfully clear by the current effort of TWA to sell its U.S.-London authority to American Airlines. These are almost certainly TWA's most valuable routes and are at the heart of an international route system that the airline has recognized, in its own submissions to the DOT, is the key to its future. ALPA believes that the sale of the routes will lead to an acceleration of the carrier's financial losses and the speedy demise of the carrier. While Congress did amend Section 401(h) last year to require the DOT to report on the effect of a route sale on a carrier's economic viability, the DOT has recently stated that the amendment contained no "new viability test" and that the department intends to consider carrier viability as just one of the many factors in assessing the appropriateness of a route transfer. In light of the DOT's position, ALPA believes that Congress should amend 401(h) so that a finding that a route sale does not adversely affect a carrier's viability is a prerequisite to any approval of a sale. In addition, because route rights belong, at bottom, not to individual carriers but to the United States, any proceeds of their sale should be used to advance public, not private, interests. Accordingly, Congress should require that any carrier that wishes to sell the rights that have been entrusted to it must first present a realistic plan of how it intends to use the proceeds of the sale to enhance its viability.

Fourth, Congress should amend the Federal Aviation Act so that significant foreign investment in U.S. carriers will be subject to prior review and approval by the DOT to ensure that a foreign entity will not have actual control over American carriers. Carriers and their foreign investors should be required to file applications for approval of the investments and interested parties should then be afforded an opportunity to review and comment on the applications. If there are material questions of fact as to whether the proposed investment would lead to actual control of the U.S. carrier, a hearing should be required. Congress should also establish a set of factors to be considered by the DOT in deciding whether to approve the investment. Among these should be whether U.S. investors can make investments comparable to the proposed investment in the airlines of the investor's home country and whether airlines of the country of the investor are in whole or part state owned.

Fifth, Congress should make it clear to the DOT that it expects the department to be more vigilant in exercising its powers to monitor the continuing fitness of airlines under Section 401(r) of the Act. In ALPA's opinion, the DOT's unwillingness to come to grips with the foreseeable adverse effects of business transactions has resulted in the financial collapse of two major carriers -- Eastern and TWA.

Sixth, Congress should resist any efforts to change the statutory prohibitions against cabotage. Permitting foreign carriers to engage in cabotage here is likely to have a devastating effect on some U.S. carriers and unlikely to provide long-term benefits to consumers or other groups. Certainly, a full congressional inquiry would have to be undertaken in connection with any effort to dilute the cabotage prohibitions.

That completes my prepared testimony. Again, thank you for inviting ALPA to testify today. I will be happy to entertain any questions the subcommittee may have.

STATEMENT OF
EDWARD R. BEAUVAIS
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
AMERICA WEST AIRLINES, INC.
BEFORE THE
AVIATION SUBCOMMITTEE
OF THE
PUBLIC WORKS AND TRANSPORTATION COMMITTEE
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 5, 1991

Mr. Chairman and Members of the Subcommittee, I am Edward R. Beauvais, Chairman and Chief Executive Officer of America West Airlines, Inc., a post deregulation airline that began operations seven and one-half years ago. The Subcommittee is to be commended for conducting these important hearings, and we very much appreciate the opportunity to testify today on the financial condition of the airline industry, the adequacy of competition, and possible legislative or administrative actions that could be undertaken by the Federal government to improve the industry's financial condition and/or to enhance industry competition.

BACKGROUND OF AMERICA WEST AIRLINES, INC.

By way of background, America West is one of the two remaining post-deregulation carriers. We began operations as a new entrant airline in August 1983 with 500 employees and three Boeing 737-200 aircraft operating to and from our Phoenix hub and the cities of Los Angeles, Kansas City, Colorado Springs and Wichita.

Since that time, we have grown dramatically. America West presently operates a fleet of 104 aircraft, including Boeing 747s, 757s, and 737s and deHavilland Dash 8s. We recently entered into an agreement to acquire up to 118 Airbus A320s, and we will operate 16 of the new aircraft by mid-1991.

The number of destinations we serve has increased from three to 59. Our operations extend throughout the mainland United States to Hawaii and Canada, and we inaugurated service to Japan on last Friday.

Because of our highly motivated and involved work force, America West has been able to grow into an airline of national scope, with the Department of Transportation categorizing us, effective January 1990, as a "major" carrier. Our available seat miles (ASMs) have grown from 2.4 billion in 1984, our first full year of operation, to 18.3 billion in 1990. Our revenue base has increased from $122.6 million in 1984 to $1.3 billion in 1990. In 1990, America West enplaned

15,624,060 passengers -- a 13,226,060 million passenger (more than sixfold) increase from the 2,398,000 enplaned in 1984.

We at America West believe that one of the important reasons that we have been able to survive, grow and prosper in today's competitive environment is our underlying management philosophy. That is, we stress the individual value of all employees and the importance of the role of every individual who works for America West in developing a profitable organization that strives to meet the needs of the traveling public.

Employee stock ownership is the cornerstone of this philosophy. Each America West employee is a shareholder. In addition, all employees participate in our incentive stock option plan which gives each one the opportunity to increase his or her holdings in the company through good performance. For many employees, their first experience with stock ownership is with America West. Through their participation, they learn that their financial security is directly tied to the financial success of their company. This employee ownership creates a unique motivational tool for employees who work with limited direct supervision and constant customer contact.

America West also provides a very liberal profit sharing program, which is, again, designed to provide incentives to create a profitable organization by delivering quality customer service.

In keeping with the emphasis on employee participation, America West has also developed a union-free workplace that provides for direct employee participation through a variety of committees staffed by employee-elected representatives. These committees establish their recommendations for work rules, pay procedures and the like.

Working as a partner in economic development with the Phoenix community, America West's service has helped transform the community from the 14th largest O&D market in the United States in 1983 to the 10th largest in 1988. Indeed, Phoenix has become the fastest growing transportation center in the U.S., with Phoenix O&D passenger levels growing at an annual rate of 11.4 percent (6.9 million annual O&D passengers in 1983 to 13.8 million annual O&D passengers by year-end second quarter 1989).

The role played by America West in this growth was significant. Of the 6.9 million increase in annual O&D passengers, 4.4 million, or 64.3 percent, traveled on America West. In providing a quality, safe, on-time product to the community of Phoenix, America West has participated significantly in the community's economic development. Using data provided by the community, America West estimates that its activities in the Phoenix metropolitan area added $6.4 billion to Phoenix' economic development during 1988. America West has created nearly 9,000 jobs in the Phoenix area, and America

West's payroll alone for the Phoenix metropolitan area exceeded $198 million in 1989.

A similar record of cooperation in economic development exists between America West and Nevada, particularly at Las Vegas, and, as at Phoenix, America West has earned the largest market share of any carrier serving Las Vegas.

Of the 62 nonstop jet destinations at Phoenix, America West provides service in 42, or 67.7 percent. Since America West first inaugurated service in 1983, the number of Phoenix markets with jet service has increased by 25, or 67.6 percent, going from 37 jet destinations in 1983 to 62 today. A similar trend is seen at Las Vegas. Since 1983, the number of markets with jet service has increased by 12, or 40.0 percent, going from 30 in 1983 to 42 jet destinations today. America West provides service in 30, or 71.4 percent, of these markets.

As to the future growth of our domestic system, we intend to continue to expand our Phoenix and Las Vegas hubs, with additional frequencies to cities that we already serve and the addition of new cities to our existing system, particularly along the West Coast where we see significant opportunities for growth. In addition, we intend to continue in our efforts to expand our route network to the East, including slot restricted airports, and eventually to the South as we take delivery of new aircraft over the next several years.

Insofar as America West's international aspirations are concerned, the Secretary of Transportation's Task Force on Competition in the U.S. Domestic Airline Industry specifically recognized the increasing importance of international routes to U.S. carriers, noting that, while only 22% of the nine major air carriers' 1988 operating revenues were earned in international markets, these international markets accounted for 34% of their 1988 operating profits. The study also pointed out that revenues and profits from international operations are important not only in and of themselves, but also, and perhaps more importantly, to provide carriers with strength to compete effectively domestically.

We at America West have recognized the important role that international service can play, and have been taking the necessary steps to position ourselves to provide such service. In this regard and while service to Europe is in our plans, our principal focus has been upon Pacific Rim service for several reasons:

First, America West is essentially a Western U.S. airline, with the bulk of our service and our two hubs being located west of the Mississippi.

Second, growth in passenger demand between the United States and the Pacific has nearly doubled since 1985, growing at an annual rate of 18.7 percent, far faster than to other parts of the world.

Third, the Western United States is a particularly popular tourist destination for Pacific Rim-originating passengers. Indeed, based on statistics provided by the U.S. Travel and Tourism Administration, five of the six most popular vacation destinations for Japanese travelers are in the West and we serve all five of them -- Los Angeles, San Francisco, Disneyland, Las Vegas and the Grand Canyon.

Fourth, a strong community of interest has begun to develop between many of the destinations on our system with a significant number of high-technology companies and similar destinations on the Pacific Rim.

Finally, the inauguration of our Hawaiian service in November 1989 has permitted America West to develop a mini-hub at Honolulu to use as a jumping-off point for international service to various Pacific Rim destinations. And, as these markets develop over the next several years, we will be able to provide nonstop service to these points, utilizing our 747-400 aircraft that are scheduled for delivery in the mid-1990's.

As I indicated previously, America West began service to Nagoya, Japan last Friday, and we intend to build on this Pacific Rim service, offering flights from our mini-hub in Honolulu to various destinations in the Pacific such as Hong Kong, Taipei, Sydney, and Seoul as well as any additional points in Japan that may become available.

EVOLUTION OF THE AIRLINE INDUSTRY SINCE THE PASSAGE OF THE AIRLINE DEREGULATION ACT

As is discussed in the study prepared by the Secretary's Competition Task Force, 99 percent of the domestic traffic revenue passenger miles was carried by the 19 trunkline and local service carriers in 1978, the year the Airline Deregulation Act was passed. And, while this percentage declined from 1978 to 1984, the 22 mergers and acquisitions approved by the Department of Transportation during the period 1985 through 1988 has resulted in a situation in which the top 5 carriers accounted for 74% of all domestic RPMs in 1988, or 5 percentage points higher than before deregulation. Task Force Study, "Industry and Route Structure", Table I-5. And, as may be seen from Exhibit A that was published in the Aviation Daily on January 29, 1991, American, United, Delta and Northwest dominated the industry on a systemwide basis in 1989 and 1990.

In recent years and based, once again, on information provided in the D.O.T. study, every major carrier expanded its hub-and-spoke operations by establishing new connecting complexes at most large F.A.A. hubs (excluding several coastal cities) and several medium F.A.A. hubs. The result has been a large increase in carrier concentration at such hubs. In July 1988, 17 of the 27 large hubs had only one or two competitors with significant shares, compared with three that had only one or two competitors in 1979. At six large hubs today, 75 percent or more of departures or enplanements are by a single carrier, and these hubs are far more concentrated than the most concentrated hub in 1979. Id., Table I-9.

While there may have been a general decline in city-pair concentration from 1979 to 1988 in the top 1,000 markets, the quality of competition in these markets is, quite significantly, related to the specific carriers providing the competition rather than the number of carriers in any given market. Thus, as may be seen from Exhibit B, which analyzes the passengers carried and fares charged in the top 1,000 city-pair markets for the year ended third quarter 1989, the three largest U.S. carriers, Delta, American and United, are able to charge fares in those top 1,000 markets that are significantly higher than the average industry fares in these markets.

Exhibit C provides further confirmation of the market power of American, United and Delta. In this regard, the column on the far right of each table of this exhibit depicts the relative advantage that a particular carrier has against the other carriers with which it competes in these 1,000 markets. As may be seen from the three charts related to American, Delta and United (Exhibit C, pages 1-3), American is able to achieve a fare premium against each carrier with which it competes, Delta is able to achieve a premium against each carrier except American, and United is able to achieve a premium against each carrier except American and Delta.

And, as may be seen from Exhibit D, it is the identity of the carrier operating a particular hub, not simply that it is a hub, which is critically important in determining the level of fares that are actually paid by U.S. consumers.[1]

Finally, Exhibit G depicts what happens when two of the largest carriers "compete" on a head-to-head basis. During the course of the 1990 U.S.-Japan Gateways Proceeding, Docket No. 46700, America West prepared several exhibits setting forth the manner in which the various applicants in that case, including American, Delta and United, compete at their hubs, including O'Hare and Dallas/Ft. Worth. As may be seen from Exhibit G, American and United each charge fares in the O'Hare markets that are higher than the industry average fare and the fares charged by other carriers at O'Hare, and, as may be seen from that same exhibit, it is only the competition provided by

---

[1] We would point out that Michael Levine, one of the early proponents of airline deregulation, has written an extensive article discussing the workings of airline markets since deregulation entitled, "Airline Competition in Deregulation Markets: Theory, Firm Strategy, and Public Policy," 4 Yale J. on Regulation 393 (1987) in which he recognized the failure of the theory of contestability in the airline industry. In addition, Professor Severin Borenstein, America West's witness in the U.S.Air-Piedmont Acquisition Proceeding, has written two articles (which are attached as Exhibits E and F for the convenience of the Subcommittee) examining airport dominance and market power in the U.S. airline industry and the competitive advantages of dominant airlines.

Midway that has kept the fares as low as they are. Similarly, American's and Delta's fares in the DFW markets are higher than the industry average fare and the fares charged by other carriers at DFW, and it is only the competition provided by Southwest that has kept the fares as low as they are. See "Airline Deregulation -- Trends in Airfares at Airports in Small and Medium-Sized Communities" (Nov. 1990), a G.A.O. report that discusses the favorable effect that the entrance of low-cost airlines, such as America West and Southwest, have on fare levels.

What these data demonstrate, of course, is that there is a direct relationship between the increasing level of concentration in the U.S. air carrier industry and the fares that are actually charged to the traveling public. And, because of this relationship, it is critically important for policymakers to focus on the size and market power of the larger carriers as well as the various barriers to entry that exist in making judgments as to the appropriate administrative and legislative actions that should be undertaken to assure the proper functioning of a fully competitive industry.

EVENTS OF THE PAST SEVEN MONTHS HAVE HAD A SIGNIFICANT ADVERSE EFFECT ON THE U.S. AIRLINE INDUSTRY

Over the past seven months, the airline industry has been buffeted by three significant developments beyond its control, the consequences of which, if not addressed in the near future, threaten the viability of the U.S. air carrier industry. First, as a result of the invasion of Kuwait by Iraq on August 2, 1990, jet fuel prices doubled for America West, going from approximately 60 cents per gallon before the invasion to $1.20 per gallon in October. Significantly, this incredible increase in prices occurred only in jet fuel prices, with gasoline and heating oil prices, the other two significant oil products, lagging far behind. Indeed, as may be seen from Exhibit H, which was prepared by the Energy Department, jet fuel spot market prices increased more than 41 percent from August to November, whereas the spot market prices for West Texas intermediate crude oil, wholesale gasoline, and No. 2 heating oil increased by only 24-26 percent. And, notwithstanding requests by various carriers that the Government take steps to ameliorate this disproportionate effect on the airlines, none of these recommendations was implemented because, it was said, there was not a "consensus" within the industry as to which particular approach should be pursued. While the prices for jet fuel have come down, the financial effects of these high fuel prices on the carriers during the third and fourth quarters were quite serious, and today's jet fuel prices are still significantly higher than the prices before the invasion and remain subject to upward spikes driven by the uncertainties related to the Persian Gulf war.

Second, the adverse effects of these increased jet fuel prices came on top of a declining U.S. economy which was already resulting in reduced traffic levels for the industry. Thus, throughout the later part of 1990, traffic continued to fall off, as U.S. businesses and discretionary travelers simply traveled less in the face of the overall softening in the U.S. economy.

The final, and perhaps today the most pernicious effect of the war in the Persian Gulf is the reduction in U.S. and, indeed, worldwide traffic as a result of governmental and business policies restricting air travel as well as the decision of discretionary passengers not to travel in the face of concerns related to terrorist threats. And, just a few days ago, the U.S. Postal Service determined not to ship mail over 16 ounces in weight by air, thus depriving U.S. airlines of an estimated $1 billion in annual revenues.

The combined effect of these three factors is that airline costs have increased significantly and traffic has fallen substantially for all carriers. While all U.S. industries have undoubtedly been affected to an extent by the events of the past seven months, it is beyond question that the adverse effects on the U.S. airline industry have been disproportionate to the effect on other U.S. industries and that, if these effects continue, the continued ability of that industry to remain viable both domestically and internationally will be seriously compromised.

ADDRESSING THE CONSEQUENCES OF INCREASING CONCENTRATION, DECREASING COMPETITION AND THE PERSIAN GULF WAR

As is apparent from this discussion, certain of the difficulties facing the U.S. airline industry are of a short-term nature while others are more long-term in nature, and, while certain of the longer-term issues clearly affect different carriers in different ways, there can be no dispute that the events of the past seven months affect all carriers in very similar ways. Indeed, the president of ATA described the threat facing the U.S. industry in the following manner:

> "The industry is in unparalleled crisis - it has never experienced the kind of threats that it faces today to its stability and financial viability. The capital structure of the entire U.S. airline industry is in the process of being systematically destroyed, whether we are talking about the wealthiest or financially strongest airlines or some of the weakest - they are all hemorrhaging cash to pay their fuel bills, and it is weakening even the longer-term ability of the strongest carriers to continue to re-equip and provide a high level of service across the board in the future. It's weakening the weak in a very threatening way, and it's weakening even the strong in a serious way."

In such an environment, any proposed administrative or legislative action to improve the financial conditions of the industry and/or to enhance industry competition must be carefully considered to assure that the proposed solution will effectively address the problems so identified and that short-term solutions to a problem do not in and of themselves create more serious long-term problems.

In the short-term, the principal problems facing the industry are coping with the financial effects of the high fuel costs paid during the fall, the elevated level of fuel costs that persist today and are likely to recur until the end of the hostilities in the Persian Gulf and the decline in traffic resulting from the recession in the U.S. economy and, more importantly today, the reaction of the traveling public to the fear of terrorist activity.

Last fall, America West and other carriers urged the Departments of Transportation and Energy to consider various alternative proposals, including "monetization" of the Strategic Petroleum Reserve and retention of the airline ticket tax, to provide the airlines with the wherewithal to deal, in one way or another, with high jet fuel prices. While jet fuel prices are lower today than they were in the fall, they nevertheless remain sigificantly above the prices paid in the months leading up to the invasion of Kuwait and are subject to significant increases in the future if the Saudi oil fields are threatened in the war.

Insofar as the decline in traffic is concerned, it is not reasonable for the airline industry to expect relief from a decline in traffic resulting from the general downturn in the U.S. economy. On the other hand, the significant reductions in traffic that are presently being experienced as a consequence of the threat of terrorism associated with the war are a direct result of national policy. Moreover, if an actual terrorist incident were to occur at an airport or on an airplane, there will be a further and perhaps more serious deterioration in traffic. Under these circumstances, it is incumbent, America West submits, upon the Federal government to develop a program that will permit the airline industry to cope with the effects of higher jet fuel prices and significantly reduced traffic levels. In this regard, what the industry needs is a program that will provide a short-term infusion of cash that can be repaid over a period of time in order to offset the short-term consequences of our national policy to enforce the U.N.'s resolutions related to the invasion of Kuwait.

While there are many that argue that changing the rules regarding foreign investment in U.S. carriers and permitting financially weak airlines to sell international routes are the "solution" to many, if not all, of these problems, careful evaluation of these proposed changes reveals that they are not the "panacea" claimed by their advocates.

Foreign Investment

Turning initially to changing the law concerning foreign investment in U.S. air carriers, America West urges that the Congress thoroughly consider the ramifications of actions that could ultimately lead to the loss of control of our domestic air transportation system, which, unlike those of other nations, is the nation's primary form of mass transportation and is responsible for the carriage of more than one-half of all passengers traveling by air throughout the world.

Indeed, before opening up the most lucrative domestic market in the world to foreign air carriers and other foreign investors, several important questions should be addressed and resolved. First and most importantly, are the competitive problems presently facing the U.S. airline industry susceptible of solution on a long-term basis by the mere infusion of foreign capital, or are other more fundamental structural and competitive problems the cause of these difficulties and the proper focus of attention? One need only look at the history of the savings and loan institutions in the United States to witness the consequences of an inadequate response to the underlying structural and regulatory problems in the early 1980s that led to the failure of many of those institutions by the end of the decade -- failures that were not averted by the "solution" of financially stronger institutions and financial entrepreneurs infusing cash into the weaker thrifts.

Second, careful consideration should be given to who those foreign investors might be. Turning once again to the savings and loan debacle, there were many instances in which the "investors" who provided the new investment did not have the long-term interest of that industry in mind but were instead motivated by the short-term benefits afforded by investment therein -- a risk that is also present in the airline industry with its well known and attractive cash flows. In addition, one must not lose sight of the fact that the present weak dollar and low airline equity prices combine to make such purchases an attractive "play". Thus, while the short-term interests of such financiers may well be satisfied by such a change in policy, it is not at all clear that the long-term interest in maintaining a viable U.S. air transportation system would be well-served by allowing such individuals increased financial participation.

If, on the other hand, the "new" investors were foreign air carriers, there is a serious question as to whether the current competitive environment would be maintained, much less enhanced. As the Department of Transportation knows all too well from numerous bilateral negotiations that have been adversely influenced by a dominant air carrier in a particular foreign country that is not eager to compete, most foreign air carriers are not aggressive competitors (particularly with respect to price) -- a not inconsequential consideration when improved competition is one of the expressed goals of those who advocate revision of the foreign investment laws.

Third, the existing bilateral agreements between the U.S. and other countries represent a careful balancing of benefits between the two countries. Simply permitting a carrier in a foreign country to "buy" its way into the lucrative domestic U.S. market by a unilateral change in U.S. law will surely undermine the integrity of those agreements.

Fourth, even if one were to assume that a change in U.S. law were not to go into effect until a similar opportunity existed in the other country, the effects of such a change on competition in the U.S. must nevertheless be evaluated. As a consequence of the various barriers to entry that exist in the U.S. today, such as the substantial financial benefits that accrue to U.S. CRS owners, only the very largest U.S. carriers will realistically be able to engage in the reciprocal purchase of an interest in, or control of, a foreign airline. If there is any hope for maintaining a competitive situation in the U.S., great care should be taken so as not to give these larger carriers yet another competitive advantage.

Finally, the Congress and the Executive Branch must each ask itself whether it is in the national interest to permit foreign control of the vital elements of our national infrastructure -- a question that takes on added significance with the present callup of our nation's civil reserve air fleet.

Route Transfers

Insofar as allowing financially weak airlines to sell international routes as a means of addressing the financial problems of the weaker carriers is concerned, several important policy considerations suggest that such transfers raise serious public interest concerns. First and perhaps most importantly, such sales have not assured the continued existence of the financially weak airlines and, indeed, may, in particular instances, substantially diminish the ability of a carrier to remain an effective competitor in the airline industry. Thus, the sale of Eastern's profitable South American route authority to American, while permitting Eastern to subsidize its otherwise unprofitable operations for a while longer, did not enhance Eastern's long-term viability. Similarly, while Pan American's sale of its profitable Pacific route authority to United permitted Pan Am to continue to operate, it finds itself, once again, in serious financial difficulty and the domestic airline industry has been left to deal with United's growing dominance in the Pacific, a presence that United is now seeking to replicate through its purchase of Pan Am's profitable London routes. In fact, as America West has pointed out in responding to the Department's show cause order related to the United-Pan American route transfer, there is a serious question as to whether Pan Am, by the very sale of its core London route authority, will, as a consequence of the sale itself, not be able to remain an effective competitor in the airline industry. Similarly, stripping TWA of its London authority may well compromise its ability to remain as an effective competitor.

Second, while the Department, in awarding limited entry routes in comparative hearings, generally chooses among several competing applications on the basis of a wide range of public interest factors, it has adopted a policy in route transfer proceedings of not permitting the filing of competing applications for one or more of the routes that are proposed to be transferred, thus precluding, by the manner in which the proceeding is structured, any ability to consider the full range of public interest considerations raised by such transfers. Indeed, one must ask the question whether, if the route authority that is presently the subject of the United-Pan Am or American-TWA proposed route transfers were the subject of a fully litigated route proceeding, D.O.T. would seriously consider awarding all of the routes to only one carrier? The question, of course, answers itself, but that is precisely what will happen if the Department determines to approve each of these route transfer applications.

Third, while the Department goes to great lengths in comparative route proceedings to justify its decision on the basis of specific public interest considerations specified in Section 102 of the Federal Aviation Act of 1958, as amended, and Secretary Skinner stated in a June 1989 letter to airline presidents that one of the criteria to be evaluated in route transfer proceedings is whether the proposed transfer undercuts the important public benefits that the Department sought to achieve by awarding the route in the first place, the Department's decisions authorizing the transfer of these routes fail in most instances to fully evaluate these considerations, thus, once again, precluding consideration of the benefits of competitive alternatives.

Fourth, it is no answer to argue that the carrier purchasing the route or routes would be a more effective competitor than the financially weak carrier that is proposing to sell its routes, because that "strawman" argument could, in all likelihood, be made with respect to any of the applicants that would be likely to apply for the authority to be transferred if it were to be reawarded in a comparative route proceeding.

Fifth, many of those route transfers, which involve purchases by the already large carriers, adversely affect industry balance and competition in the domestic airline industry. In this regard, the proposed transfer of Pan Am's and TWA's London authority to United and American, respectively, and the proposed transfer of Hawaiian's Australian and Japanese authority to one of the two dominant U.S. carriers in the Pacific, Northwest, would, without doubt, have serious and long-term adverse competitive consequences in the Atlantic, Pacific and domestically as carriers are foreclosed from competing for traffic flows, and, as to each of these proposed transfers, there are other carriers that are fit, willing, able and eager to provide these services.

Finally, only the large and financially strong carriers are in a position to pay millions of dollars for such route authority. Thus, it should come as no surprised that it is the owners of the "cash cow" computer reservation systems, United and American, and the beneficiary of the recent change in D.O.T. policy regarding foreign investment, Northwest, that have proposed to purchase these routes and, in the case of Northwest, take a significant ownership position in Hawaiian.

This phenomenon of the rich getting richer does not, of course, have to be the case. Thus, the Department could develop, for example, a mechanism by which a financially weak carrier's routes would be set down for reallocation in a comparative hearing open to all carriers (as is otherwise the case when the Department awards route authority), the routes would then be awarded to the various applicants on the basis of the pro-competitive public interest policies set forth in

Section 102 of the Act, and each carrier that was awarded such a route would be required to share a percentage of the profits generated on the route over a period of time as determined in the proceeding with (a) the U.S. Government for the purpose of assuring, for example, that any liabilities, contingent or otherwise, that might be incurred by the Pension Benefit Guarantee Corporation are satisfied, (b) the financially weak carriers' creditors if appropriate under the circumstances, and (c) finally, with the carrier itself. And, I am sure that there are a great many other ways in which such routes could be reallocated in a far more competitive way than simply approving their transfer to the highest bidder.

In the last analysis, it is critically important for the Department of Transportation and the Congress not to lose sight of the important public, as opposed to the private airline, interest considerations in these proceedings. What this means is that the Department should modify its policy of not considering competing applications in proceedings involving the transfer of specific routes with significant competitive implications and develop creative mechanisms for redistributing these routes in order to protect the public interest and assure the competitive viability of the U.S. airline industry.

Computer Reservation Systems

As noted *supra*, it should come as no surprise that American and United, the owners of the two largest computer reservation systems in the United States, are the principal purchasers of route authority from the financially weak carriers. Indeed, American has itself purchased or proposed to purchase over $1.1 billion in airline assets in the last year. Aviation Daily (Dec. 19, 1990) at 525.

Why is this? Because American and United, through their ownership and control of these CRS systems, have access to significant amounts of cash resulting from the incredible profitability of these systems as presently regulated. Thus, based upon information provided in a study of computer reservation systems completed by the Department of Transportation in 1988 and using American as an example (although quite similar results would apply to United's operations as well), American collects fees in the range of $215 million per year from airlines whose flights are booked in its Sabre system. In addition, D.O.T. has estimated that American receives an additional $328 million per year in higher airline revenues due to the fact that travel agents book more travel on American using the American CRS than they would using a truly neutral and non-affiliated CRS (a phenomonom that is known in the industry as the "halo effect"). Moreover, since that money was obtained either directly (fees) or indirectly (halo effect) from its competitors, American has a $1 billion advantage over its competitors every year from operating a business that has nothing to do with the fares or services offered by a carrier.

Finally, while these revenues are significant in and of themselves, the D.O.T. study found that 57% of the booking fees American collects from its competitors and as much as 80% of the higher airline revenues resulting from the so-called halo effect were profits, thus indicating that American receives approximately $382 million in net cash each year by which to finance its purchases.

Under these circumstances, it is imperative that the Department and the Congress vigorously and expeditiously address the many critical issues raised by ownership of the CRS systems by American and United.

Airport Access

One final matter merits comment. While the issue of airport access was not specifically identified by the Subcommittee for comment, one of the most significant, if not the most significant, motivations for many of the airline acquisitions that occurred in the mid-1980s was to gain competitive control of the operating environment at the affected airports -- a result which is both antithetical to the goals of airline deregulation and stands as a serious impediment to a carrier like America West being able to initiate or expand its operations as it attempts to grow.

The General Accounting Office, in a report entitled "Airline Competition - Industry Operating and Marketing Practices Limit Market Entry" (August 1990), found that airport access barriers to entry have grown in recent years in ways not anticipated when the industry was deregulated, including several physical constraints such as slots at the high density airports, control of gates and noise restrictions, and we will not reiterate those findings here. But, while the legislation recently passed by Congress has addressed certain of these concerns, these provisions have not yet been implemented and there are new, unanticipated storm clouds on the horizon arising out of the liquidation of Eastern's assets.

As the Committee may be aware, the Justice Department has expressed to the bankruptcy court its concern with respect to the proposed disposition of Eastern's airport assets at Atlanta, Washington National, LaGuardia, O'Hare and Los Angeles, which, in each instance, were purchased by the four largest carriers in the United States -- American, United, Delta and Northwest. It is critically important as this liquidation proceeds that the pro-competitive public interest factors that Congress has delineated in Section 102 of the Act play a role in the disposition of these assets (most particularly the F.A.A. created slots that are clearly subject to the Act) rather than the desire of Eastern's creditors to sell the assets to the highest bidder regardless of the competitive consequences. The Departments of Transportation and Justice are aware of these issues, and we implore them to act in a manner that is designed to assure a competitive U.S. airline industry.

* * *

Mr. Chairman, I am convinced that a failure by the federal government to act now will eliminate the options which currently exist to preserve competition and the many benefits of airline deregulation. A consolidation of the industry into three or four carriers will result in higher fares and service dislocations and there will be irresistable pressure to return to route and rate regulation or the surrender of some of our domestic market to foreign competition. I am equally convinced, however, that prompt action to address the short-term liquidity problem and long-term structural problems will result in a healthy domestic airline industry and ensure that Americans continue to enjoy the benefits of airline deregulation.

We very much appreciate the opportunity to present this testimony, and I would be pleased to respond to any questions that the Subcommittee may have.

AVIATION DAILY January 29, 1991

U.S. Industry Traffic Market Share
(000)

12 Months 1990

		RPMs	Share (%)
1.	American	76,956,989	16.958
2.	United	75,945,637	16.736
3.	Delta	58,983,900	12.998
4.	Northwest	51,491,084	11.347
5.	Continental	39,173,562	8.632
6.	USAir	35,550,516	7.834
7.	TWA	34,236,500	7.544
8.	Pan Am	30,676,000	6.760
9.	Eastern	16,692,131	3.678
10.	America West	11,114,444	2.449
11.	Southwest	9,958,940	2.195
12.	Midway	4,944,076	1.090
13.	Alaska	4,494,000	0.990
14.	WestAir	633,781	0.140
15.	Metro	633,487	0.140
16.	Aloha	617,303	0.136
17.	Air Wisconsin	486,563	0.107
18.	Atlantic SE	426,865	0.094
19.	Comair	382,841	0.084
20.	Horizon	357,400	0.079
	Total	453,786,808	

		ASMs	Share (%)
1.	American	123,575,152	16.982
2.	United	114,657,591	15.757
3.	Delta	99,781,400	13.712
4.	Northwest	77,320,446	10.626
5.	Continental	64,844,123	8.911
6.	USAir	59,483,512	8.174
7.	TWA	54,958,100	7.553
8.	Pan Am	46,736,000	6.423
9.	Eastern	27,649,169	3.800
10.	America West	18,286,136	2.513
11.	Southwest	16,411,115	2.255
12.	Midway	8,488,807	1.167
13.	Alaska	8,382,000	1.152
14.	WestAir	1,427,663	0.196
15.	Metro	1,140,734	0.157
16.	Air Wisconsin	1,060,612	0.146
17.	Aloha	1,004,400	0.138
18.	Comair	891,217	0.122
19.	Atlantic SE	855,760	0.118
20.	Horizon	718,900	0.099
	Total	727,673,856	

		LF (%)
1.	Northwest	66.6
2.	United	66.2
3.	Pan Am	65.6
4.	American	62.3
5.	TWA	62.3
6.	Aloha	61.5
7.	America West	60.8
8.	Southwest	60.7
9.	Continental	60.4
10.	Eastern	60.4
11.	USAir	59.8
12.	Delta	59.1
13.	Midway	58.2
14.	Metro	55.5
15.	Alaska	53.6
16.	Atlantic SE	49.9
17.	Horizon	49.6
18.	Air Wisconsin	45.8
19.	WestAir	44.4
20.	Comair	43.0
		62.4

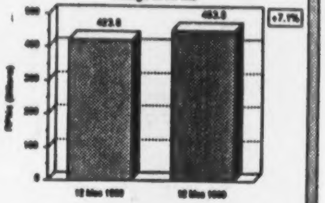
12 Months 1989

		RPMs	Share (%)
1.	American	73,480,583	17.339
2.	United	69,591,003	16.421
3.	Delta	59,348,100	14.004
4.	Northwest	45,663,051	10.775
5.	Continental	38,771,732	9.149
6.	TWA	35,046,300	8.270
7.	USAir	33,697,439	7.952
8.	Pan Am	28,808,000	6.798
9.	Eastern	11,585,800	2.734
10.	Southwest	9,281,992	2.190
11.	America West	7,933,984	1.872
12.	Alaska	4,061,000	0.958
13.	Midway	3,559,114	0.840
14.	Aloha	533,477	0.126
15.	WestAir	490,221	0.116
16.	Metro	484,852	0.114
17.	Air Wisconsin	434,362	0.102
18.	Atlantic SE	413,407	0.098
19.	Horizon	314,800	0.074
20.	Comair	280,499	0.066
	Total	423,760,326	

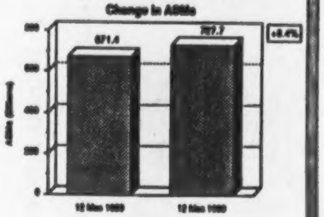
		ASMs	Share (%)
1.	American	115,173,713	17.154
2.	United	104,445,056	15.556
3.	Delta	93,571,100	13.937
4.	Northwest	70,212,866	10.458
5.	Continental	62,891,083	9.367
6.	TWA	57,230,400	8.524
7.	USAir	55,610,102	8.283
8.	Pan Am	45,236,000	6.738
9.	Eastern	19,094,800	2.844
10.	Southwest	14,796,732	2.204
11.	America West	13,724,514	2.044
12.	Alaska	7,324,000	1.091
13.	Midway	6,291,729	0.937
14.	WestAir	1,093,966	0.163
15.	Air Wisconsin	929,779	0.138
16.	Metro	917,879	0.137
17.	Aloha	844,807	0.126
18.	Atlantic SE	791,087	0.118
19.	Comair	624,206	0.093
20.	Horizon	601,800	0.090
	Total	671,406,956	

		LF (%)
1.	United	66.6
2.	Northwest	65.0
3.	American	63.8
4.	Pan Am	63.7
5.	Delta	63.4
6.	Aloha	63.2
7.	Southwest	62.7
8.	Continental	61.6
9.	TWA	61.2
10.	Eastern	60.7
11.	USAir	60.6
12.	America West	57.8
13.	Midway	56.6
14.	Alaska	55.4
15.	Metro	52.8
16.	Horizon	52.3
17.	Atlantic SE	52.3
18.	Air Wisconsin	46.7
19.	Comair	44.9
20.	WestAir	44.8
		63.1

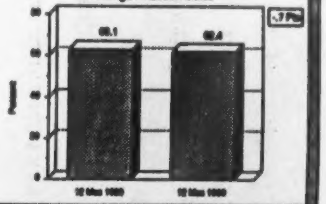
Change in RPMs



Change in ASMs



Change in Load Factor



Source: Airline Economics, Inc. for Aviation Daily

COPYRIGHT © 1991 McGRAW-HILL, INC.

Exhibit A

Exhibit B

COMPARISON OF MAJOR CARRIER O&D STATISTICS IN THE TOP 1,000 DOMESTIC CITY-PAIR MARKETS

YE 3Q 1989

CARRIER	MARKETS SERVED	O&D PAX	NON-STOP AVG HAUL	AVERAGE FARES CAR	IND	FARE RATIO%	RPM'S (Mil)	SHARES MKT	PAX	RPM
	1/	2/	3/	4/	5/	6/	7/	8/	9/	10/
Delta	460	25,631,830	994	$159.68	$144.86	110.2%	25,478	22.7%	14.7%	14.5%
American	546	25,980,500	1,119	161.99	151.79	106.7%	29,072	27.0%	14.9%	16.5%
United	390	25,995,100	1,279	171.63	163.15	105.2%	33,248	19.3%	14.9%	18.9%
USAir/Piedmont	1,324	27,932,600	619	114.39	114.16	100.2%	17,290	65.5%	16.0%	9.8%
Continental	398	20,593,100	1,148	153.54	155.23	98.9%	23,641	19.7%	11.8%	13.4%
Northwest	229	14,496,100	1,075	143.68	150.44	95.5%	15,583	11.3%	8.3%	8.9%
TWA	185	10,581,660	1,265	145.06	162.24	89.4%	13,386	9.1%	6.1%	7.6%
Eastern	202	9,164,100	868	117.44	135.20	86.9%	7,954	10.0%	5.2%	4.5%
Pan Am	82	7,031,080	805	99.41	122.36	81.2%	5,660	4.1%	4.0%	3.2%
America West	103	7,401,780	628	78.95	114.50	69.0%	4,648	5.1%	4.2%	2.6%
TOTALS/AVERAGES	2,022	174,807,850	1,007	143.57	143.74	99.9%	175,961			

1/ Total airport-pairs with carrier-specific traffic within the top 1,000 city-pairs.

2/ Total O&D passengers carried among the top 1,000 city-pairs.

3/ Average nonstop trip distance traveled by the passengers in column 2/.

4/ Average fare paid by the passengers in column 2/. This figure excludes the impact of frequent flyer travel.

5/ Average fare paid by the passengers in column 2/ had all paid the industry average fare. Industry average fare = $EXP[1.738674 + (.491586 X $LN(nonstop miles)) + (-.08014 X average coupons)].

6/ Actual average fare from 4/ as a percent of the industry average fare from 5/.

7/ Total nonstop RPM's generated by the passengers in column 2/.

8/ Percentage of airport-pairs served by the specified carrier within the top 1,000 city-pair markets.

9/ Carrier share of total O&D passengers.

10/ Carrier share of total nonstop RPM's.

Exhibit C
Page 1 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

AMERICAN COMPARED TO OTHER MAJOR CARRIERS

AA COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE AA ADV / (DISADV)
	AA	COMP	AA	COMP	AA	COMP	
Northwest	5,999,940	4,664,340	24.9%	35.7%	107.0%	80.9%	32.3%
USAir	7,011,010	7,422,140	29.1%	27.6%	113.0%	86.7%	30.3%
Pan Am	3,022,280	2,823,810	12.6%	41.6%	105.5%	81.2%	29.9%
America West	1,873,820	1,136,300	7.8%	15.8%	103.7%	80.8%	28.3%
Continental	8,375,080	8,482,730	34.8%	44.2%	108.1%	91.7%	17.9%
TWA	5,734,080	4,489,300	23.8%	48.1%	99.3%	84.5%	17.5%
Eastern	3,700,800	4,483,840	15.4%	53.0%	90.4%	80.3%	12.6%
Delta	11,201,840	12,813,880	46.6%	53.8%	108.9%	101.6%	7.2%
United	10,269,420	16,251,940	42.7%	66.3%	110.6%	105.0%	5.3%
Southwest	4,160,670	NA	17.3%	NA	77.9%	NA	NA
NONE	1,216,490	NA	5.1%	NA	119.9%	NA	NA
American Total	24,056,140				106.8%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 2 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

DELTA COMPARED TO OTHER MAJOR CARRIERS

DL COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE DL ADV / (DISADV)
	DL	COMP	DL	COMP	DL	COMP	
America West	1,448,190	2,520,530	6.1%	35.2%	93.9%	56.9%	65.0%
Eastern	11,772,520	5,713,570	49.4%	67.5%	112.3%	86.5%	29.8%
USAir	9,334,670	7,175,490	39.2%	26.6%	106.4%	89.1%	19.4%
Northwest	4,127,400	3,447,650	17.3%	26.4%	99.3%	83.2%	19.4%
Pan Am	1,522,990	1,713,120	6.4%	25.3%	96.5%	82.5%	17.0%
Continental	8,544,980	7,147,330	35.9%	37.2%	99.4%	89.2%	11.4%
TWA	3,075,870	2,454,120	12.9%	26.3%	96.0%	89.1%	7.7%
United	6,036,480	7,813,740	25.3%	31.9%	104.5%	98.6%	6.0%
American	12,813,880	11,201,840	53.8%	46.6%	101.6%	108.9%	-6.7%
Southwest	1,698,440	NA	7.1%	NA	66.2%	NA	NA
NONE	1,918,270	NA	8.1%	NA	121.6%	NA	NA
Delta Total	23,819,310				109.8%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 3 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

UNITED COMPARED TO OTHER MAJOR CARRIERS

UA COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE UA ADV / (DISADV)
	UA	COMP	UA	COMP	UA	COMP	
USAir	8,174,460	5,672,920	33.4%	21.1%	106.7%	82.3%	29.6%
Northwest	9,697,760	4,728,250	39.6%	36.1%	101.7%	84.4%	20.5%
Pan Am	2,748,050	1,302,380	11.2%	19.2%	96.2%	82.8%	16.2%
Eastern	1,344,090	1,036,990	5.5%	12.3%	93.1%	81.5%	14.2%
TWA	6,657,270	2,775,690	27.2%	29.7%	98.6%	86.5%	14.0%
America West	2,513,460	762,660	10.3%	10.6%	99.8%	88.1%	13.3%
Continental	13,278,000	7,628,990	54.2%	39.7%	102.6%	95.6%	7.3%
American	16,251,940	10,269,420	66.3%	42.7%	105.0%	110.6%	-5.1%
Delta	7,813,740	6,036,480	31.9%	25.3%	98.6%	104.5%	-5.6%
Southwest	3,126,890	NA	12.8%	NA	89.5%	NA	NA
NONE	2,313,860	NA	9.4%	NA	114.5%	NA	NA
United Total	24,505,250				105.1%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

CONTINENTAL COMPARED TO OTHER MAJOR CARRIERS

CO COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE CO ADV / (DISADV)
	CO	COMP	CO	COMP	CO	COMP	
America West	1,156,760	901,270	6.0%	12.6%	92.5%	76.9%	20.3%
Pan Am	1,149,640	1,325,040	6.0%	19.5%	89.7%	80.2%	11.8%
Eastern	3,468,270	2,949,400	18.1%	34.8%	88.2%	82.0%	7.6%
Northwest	3,387,410	4,768,000	17.6%	36.5%	89.2%	84.8%	5.2%
USAir	6,852,240	5,059,390	35.7%	18.8%	97.5%	94.5%	3.2%
TWA	2,326,360	1,486,300	12.1%	15.9%	91.0%	90.7%	0.3%
United	7,628,990	13,278,000	39.7%	54.2%	95.6%	102.6%	-6.8%
Delta	7,147,330	8,544,980	37.2%	35.9%	89.2%	99.4%	-10.3%
American	8,482,730	8,375,080	44.2%	34.8%	91.7%	108.1%	-15.2%
Southwest	2,694,320	NA	14.0%	NA	85.9%	NA	NA
NONE	2,470,630	NA	12.9%	NA	115.8%	NA	NA
Continental Total	19,209,910				99.3%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 4 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

TWA COMPARED TO OTHER MAJOR CARRIERS

TW COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE TW ADV / (DISADV)
	TW	COMP	TW	COMP	TW	COMP	
America West	792,170	926,380	8.5%	12.9%	82.1%	69.6%	18.0%
USAir	1,506,080	1,838,490	16.1%	6.8%	91.2%	83.1%	9.7%
Eastern	1,818,550	2,071,590	19.5%	24.5%	84.1%	77.3%	8.8%
Northwest	2,001,430	1,688,600	21.4%	12.9%	84.9%	78.4%	8.3%
Pan Am	2,901,900	3,341,040	31.1%	49.2%	78.7%	77.3%	1.8%
Continental	1,486,300	2,326,360	15.9%	12.1%	90.7%	91.0%	-0.3%
Delta	2,454,120	3,075,870	26.3%	12.9%	89.1%	96.0%	-7.2%
United	2,775,690	6,657,270	29.7%	27.2%	86.5%	98.6%	-12.3%
American	4,489,300	5,734,080	48.1%	23.8%	84.5%	99.3%	-14.9%
Southwest	1,763,610	NA	18.9%	NA	78.7%	NA	NA
NONE	1,835,630	NA	19.7%	NA	111.3%	NA	NA
TWA Total	9,339,260				89.0%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 5 of 10

Exhibit C
Page 6 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

USAIR COMPARED TO OTHER MAJOR CARRIERS

US COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE US ADV / (DISADV)
	US	COMP	US	COMP	US	COMP	
Pan Am	2,036,810	1,300,850	7.6%	19.2%	86.5%	72.9%	18.7%
Eastern	4,730,510	4,215,790	17.6%	49.8%	94.8%	84.9%	11.7%
America West	1,644,260	2,633,870	6.1%	36.7%	69.6%	66.6%	4.5%
Continental	5,059,390	6,852,240	18.8%	35.7%	94.5%	97.5%	-3.1%
Northwest	2,635,100	2,474,000	9.8%	18.9%	87.2%	91.8%	-5.0%
TWA	1,838,490	1,506,080	6.8%	16.1%	83.1%	91.2%	-8.9%
Delta	7,175,490	9,334,670	26.6%	39.2%	89.1%	106.4%	-16.3%
United	5,672,920	8,174,460	21.1%	33.4%	82.3%	106.7%	-22.9%
American	7,422,140	7,011,010	27.6%	29.1%	86.7%	113.0%	-23.3%
Southwest	1,577,060	NA	5.9%	NA	46.7%	NA	NA
NONE	8,968,300	NA	33.3%	NA	120.9%	NA	NA
USAir Total	26,933,230				100.2%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 7 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

NORTHWEST COMPARED TO OTHER MAJOR CARRIERS

NW COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE NW ADV / (DISADV)
	NW	COMP	NW	COMP	NW	COMP	
USAir	2,474,000	2,635,100	18.9%	9.8%	91.8%	87.2%	5.3%
America West	708,780	319,430	5.4%	4.5%	81.1%	80.4%	0.9%
Continental	4,768,000	1,387,410	36.5%	17.6%	84.8%	89.2%	-4.9%
TWA	1,688,600	2,001,430	12.9%	21.4%	78.4%	84.9%	-7.7%
Eastern	1,239,680	1,654,120	9.5%	19.5%	80.5%	89.9%	-10.5%
Pan Am	657,020	2,307,150	5.0%	34.0%	76.0%	85.8%	-11.4%
Delta	3,447,650	4,127,400	26.4%	17.3%	83.2%	99.3%	-16.2%
United	4,728,250	9,697,760	36.1%	39.6%	84.4%	101.7%	-17.0%
American	4,664,340	5,999,940	35.7%	24.9%	80.9%	107.0%	-24.4%
Southwest	1,711,380	NA	13.1%	NA	75.1%	NA	NA
NONE	3,598,660	NA	27.5%	NA	118.1%	NA	NA
Northwest Total	13,080,060				96.3%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 8 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

EASTERN COMPARED TO OTHER MAJOR CARRIERS

EA COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE EA ADV / (DISADV)
	EA	COMP	EA	COMP	EA	COMP	
Northwest	1,654,120	1,239,680	19.5%	9.5%	89.9%	80.5%	11.7%
Pan Am	3,150,790	3,810,810	37.2%	56.2%	88.6%	87.8%	0.9%
Continental	2,949,400	3,468,270	34.8%	18.1%	82.0%	88.2%	-7.0%
TWA	2,071,590	1,818,550	24.5%	19.5%	77.3%	84.1%	-8.1%
USAir	4,215,790	4,730,510	49.8%	17.6%	84.9%	94.8%	-10.4%
American	4,483,840	3,700,800	53.0%	15.4%	80.3%	90.4%	-11.2%
United	1,036,990	1,344,090	12.3%	5.5%	81.5%	93.1%	-12.5%
Delta	5,713,570	11,722,520	67.5%	49.2%	86.5%	112.3%	-23.0%
Southwest	0	NA	0.0%	NA	NA	NA	NA
NONE	164,260	NA	1.9%	NA	97.7%	NA	NA
America West	0	2,520,530	0.0%	35.2%	NA	NA	NA
Eastern Total	8,465,090				86.9%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 9 of 10

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

PAN AM COMPARED TO OTHER MAJOR CARRIERS

PA COMPETITORS	O&D PASSENGERS PA	O&D PASSENGERS COMP	% OF TOTAL PAX PA	% OF TOTAL PAX COMP	CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE PA	CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE COMP	RELATIVE PA ADV / (DISADV)
Northwest	2,307,150	657,020	34.0%	5.0%	85.8%	76.0%	12.9%
America West	335,700	63,550	4.9%	0.9%	87.6%	87.7%	-0.1%
Eastern	3,810,810	3,150,790	56.2%	37.2%	87.8%	88.6%	-0.9%
TWA	3,341,040	2,901,900	49.2%	31.1%	77.3%	78.7%	-1.8%
Continental	1,325,040	1,149,640	19.5%	6.0%	80.2%	89.7%	-10.6%
United	1,302,380	2,748,050	19.2%	11.2%	82.8%	96.2%	-13.9%
Delta	1,713,120	4,127,400	25.3%	17.3%	82.5%	96.5%	-14.5%
USAir	1,300,850	2,036,810	19.2%	7.6%	72.9%	86.5%	-15.7%
American	2,823,810	3,022,280	41.6%	12.6%	81.2%	105.5%	-23.0%
Southwest	26,840	NA	0.4%	NA	31.6%	NA	NA
NONE	76,320	NA	1.1%	NA	66.1%	NA	NA
Pan Am Total	6,784,320				79.8%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

COMPARISON OF RELATIVE FARE LEVELS IN THE TOP 1,000 O&D MARKETS

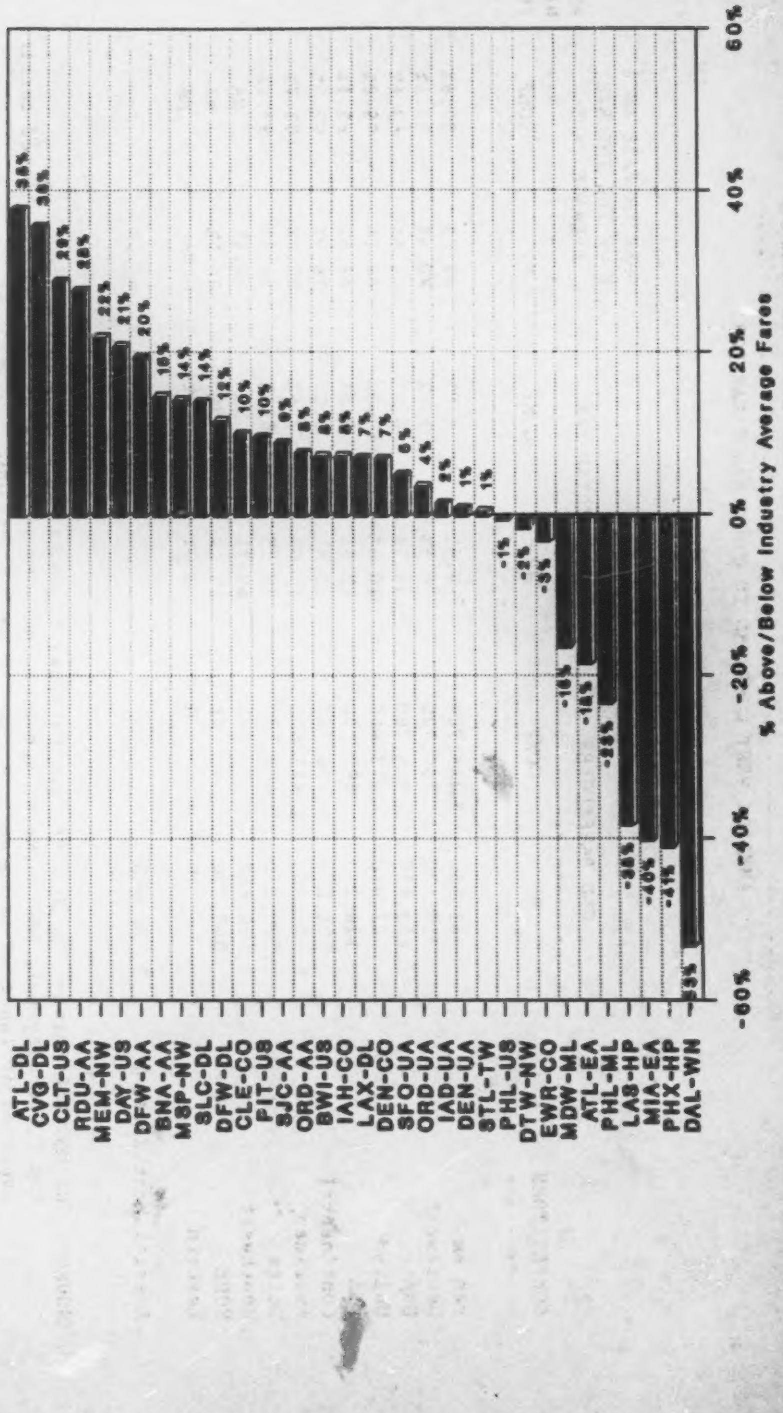
AMERICA WEST COMPARED TO OTHER MAJOR CARRIERS

HP COMPETITORS	O&D PASSENGERS		% OF TOTAL PAX		CARRIER FARE AS A % OF THE INDUSTRY AVERAGE FARE		RELATIVE HP ADV / (DISADV)
	HP	COMP	HP	COMP	HP	COMP	
Pan Am	63,550	335,700	0.9%	4.9%	87.7%	87.6%	0.1%
Northwest	319,430	708,780	4.5%	5.4%	80.4%	81.1%	-0.9%
USAir	2,633,870	1,644,260	36.7%	6.1%	66.6%	69.6%	-4.3%
United	762,660	2,513,460	10.6%	10.3%	88.1%	99.8%	-11.7%
TWA	926,380	792,170	12.9%	8.5%	69.6%	82.1%	-15.2%
Continental	901,270	1,156,760	12.6%	6.0%	76.9%	92.5%	-16.9%
American	1,136,300	1,873,820	15.8%	7.8%	80.8%	103.7%	-22.1%
Delta	2,520,530	1,448,190	35.2%	6.1%	56.9%	93.9%	-39.4%
Southwest	3,464,860	NA	48.3%	NA	46.4%	NA	NA
NONE	869,230	NA	12.1%	NA	84.5%	NA	NA
Eastern	0	0	0.0%	0.0%	NA	NA	NA
America West Total	7,170,640				67.5%		

SOURCE: US DOT O&D Survey, YE 3Q 1989, per Database Products.
Top 1,000 city-pair O&D markets; subset of airport pair markets in which the listed carrier reported at least 10 passengers per day in each direction.

Exhibit C
Page 10 of 10

Exhibit D



FARE COMPARISONS BY HUB CITY/CARRIER

First Quarter 1990

Exhibit E

Institute of Public Policy Studies Discussion Paper #278

Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry

by

Severin Borenstein*

March, 1988

Abstract: In the 10 years since airline deregulation, mergers and the restructuring of route systems into hub-and-spoke networks have greatly increased the concentration of air travel at many airports. Though the existence of hubs may raise product quality or create efficiencies in production, this paper demonstrates that dominance of the traffic at an airport allows an airline to increase its prices. A model of frequent flyer programs shows that these and other loyalty-inducing devices may be used by a multiproduct incumbent to deter entry into any of the markets it serves. A dominant firm could also gain market power through ownership of most of the gates or takeoff and landing slots at an airport. The empirical analysis that follows indicates that, controlling for cost and product quality factors, airlines charge higher prices when they have a large share of traffic either on a route or at the endpoint airports.

*Department of Economics and Institute of Public Policy Studies, University of Michigan, Ann Arbor, MI 48109-1220, 313-764-6133. The author thanks Keith Anderson, Mark Bagnoli, Michael Levine, Dan Kaplan, Jeff MacKie-Mason, Peter Reiss, Nancy Rose, and seminar participants at the University of Michigan, M.I.T., the U.S. Department of Justice, and the Federal Trade Commission. Financial support from the National Science Foundation is gratefully acknowledged.

> "[T]here is still much to do before we can be confident that we have established a northeast stronghold that is as impervious as possible. Ideally we should control a major portion of the traffic at each of the cities in the northeast. The beauty of the niche strategy is not just the marketing identity and control that it gives us. In addition, it enables us to keep control of prices within our niche territory, thus insulating a significant portion of our traffic from the devastating effects of unbridled price competition."
>
> -- Randall Malin, Executive Vice-President of USAir, 1985
> (internal memo to the President and CEO of USAir)

I. Introduction

In the last three years, the Department of Transportation (DOT) has approved more than a dozen mergers among U.S. airlines. In some of these cases, the airlines were direct competitors, serving the same airports on a large scale, as well as offering flights in the same regions of the country and on the same routes.[1] In those cases where the applicants were actual or likely potential competitors, the Department found that the merger would not substantially lessen competition or the competitive threat from other actual and potential competitors in the industry.

Underlying these findings has been the assertion that the airline industry is highly contestable. The merger applicants in these cases have generally argued that there were many firms serving the endpoints of the city-pair markets in question and that those firms could easily enter the routes competitively. Implicit in this argument is the assumption that airport presence makes a firm a viable potential competitor regardless of the size of its operations at the endpoint airports. Thus, one could infer, even if an airline carries a dominant share of traffic to and from an airport, it would be able to exercise little market power if there are many other carriers present.

Table 1 gives *prima facie* evidence that this is not the case. At each of the large U.S. airports that is dominated by 1 or 2 airlines, the dominant airline charges much higher prices than throughout the remainder of its system. A first-cut examination of possible cost factors doesn't seem to explain the price difference. Airlines have somewhat higher load factors out of their hubs than on their other flights, thus lowering per passenger costs. Furthermore, passengers traveling to or from a carrier's hub take flights that are usually about as long or longer than the flights of the airline's other customers, so the fact that shorter flights have higher per-mile costs also does not appear to explain the hub/non-hub price difference. Finally, Table 1 also indicates that a high share of traffic at an airport, not just concentration among all airlines, that contributes to market power; the dominant airline at these airports charges higher prices than other major airlines with smaller operations there.[2]

---

[1] The clearest examples of such cases are the Northwest/Republic and TWA/Ozark mergers, both approved in 1986.

[2] The two exceptions to this in Table 1, Northwest at MSP(Minneapolis) and United at ORD(Chicago), are both cases

There is substantial anecdotal evidence that an airline with a dominant share of the traffic at an airport is able to establish barriers to entry onto the routes that it serves from that airport.[3] There are also indications that a dominant incumbent airline may be able to maintain its market position in the face of entry while maintaining prices well above those of the entrant.[4] This paper attempts to diagnose, in greater detail, the relationship between a carrier's prices and the presence of competition, actual and potential. In doing so, it adds to the growing literature that rejects contestability as an adequate model for analysis of airline city-pair markets; I find that the level of actual competition on a route affects the prices charged. Furthermore, the results indicate that the extent to which potential competitors will discipline an airline's prices depends upon the size of the incumbent airline's operations at endpoint airports relative to the operations of all other airlines.

There are a number of reasons that a carrier with a large share of the traffic at an airport may be able to deter entry or lessen the competitiveness of airlines that do try to enter the dominant airline's routes. A distinction can be drawn between competitive advantages that occur naturally, such as the dominant reputation that a carrier might acquire as a natural consequence of offering most of the flights to and from a city, and advantages that result from institutions created by the airlines. These include frequent flyer programs and reward systems for travel agents that pay bonuses when the agent books more travel with the dominant airline to the exclusion of other airlines. Control of the computer reservation systems used by travel agents has also been argued to give an airline advantages over its competitors. Finally, at crowded airports, there is some evidence that a dominant airline may be able to inhibit potential competitors' abilities to obtain gates and other facilities necessary for entry or expansion of service at the airport.

The following Section presents a model of the entry-deterring effects of frequent flyer programs when one firm offers service from an airport on many different routes. It is shown that the likelihood of profitable entry on a small number of routes may be diminished by these programs. By limiting the competitiveness of an entrant on a single route, a dominant incumbent may be able to raise the necessary scale of entry and, thus, the associated sunk costs. Section III discusses, in a more institutional context, some of the other factors that may work to the advantage of an incumbent both in deterring entry and in competing with other firms if entry does occur. Section

---

in which there is a second dominant airline included in the "Other Major Airlines" category. When Republic (37% of enplanements) is removed from MSP, the average yield of other majors is 11.2¢. Removing American (28% of enplanements) from ORD changes the average yield of other major airlines to 14.8¢.

[3] The quote at the beginning of this paper is representative of the views of many airline executives. In the USAir-Piedmont merger case, Piedmont's Vice-President for Planning stated that they would never consider entering the Pittsburgh-Washington DC market because of USAir's dominant position at Pittsburgh. He said, however, that Piedmont might compete with USAir from its own hub, Baltimore, to Pittsburgh because "that is strength against strength." (USAir-Piedmont Acquisition Case, USDOT, Docket 44719, transcript p. 615, testimony of Richard T. James, July 23, 1987.) See also *Wall Street Journal*, July 20, 1987.

[4] On the Pittsburgh-Philadelphia route, both endpoints being USAir hubs, USAir has maintained prices more than 80% above those of 3 different airlines that have entered the route since 1980. In each case, the entrant has pulled-out of the route after carrying traffic loads that are unlikely to have been profitable.

IV describes the data set used for empirical analysis of these effects, the model that is estimated and the estimation technique. The results, presented in Section V, indicate that share of traffic at endpoint airports and share of traffic on the route both have significant positive effects on the price that an airline charges. Conclusions and policy implications are discussed in Section VI.

II. A Model of Entry-Deterring Frequent Flyer Programs

Frequent Flyer programs (FFP's) were introduced in the airline industry in 1980, but similar loyalty-inducing devices have been used for years. Trading stamps, very popular in the 1960's among gas stations, supermarkets and other stores that serve primarily repeat clientele, also engendered some degree of loyalty inducement.[5] More recently, many car rental agencies, motel and hotel chains, and credit cards companies have begun to offer bonuses to buyers who purchase their service repeatedly.

It is noteworthy that the recent users of such programs are firms selling many heterogeneous products, differentiated at least by location, and that the payoff schedules are non-linear. The marginal payoff from additional business with one of these companies increases with the amount of business conducted.[6] Further, these firms derive much of their revenue from business people who are making purchases for which they do not directly bear the full cost. Yet, the bonuses are given directly to the purchaser, rather than to his or her company.

An extremely simple model of FFP's points out one way in which such programs might deter entry by slowing the switch to a lower-priced entrant and, thus, by lowering the present value of the entrant's profits in the market. Assume that each traveler takes at most one flight per period on a certain monopolized route and that the incumbent firm sells at the monopoly price of P_m. An entrant with lower costs could enter and immediately induce all customers to switch by charging a price just below the incumbent's unit cost.[7] Now, before the entrant appears, allow the incumbent to begin selling tickets only in (non-transferable) pairs. A consumer would use one ticket in the period in which the pair is bought and one ticket in the following period. The monopoly price of the pair would be $P_m + P_m/(1+i)$ and consumption at that price would be unchanged from the case of unpaired sales. When entry occurs thereafter, about half of all customers will be in the middle of a pair of tickets and will not switch until at least one period after entry. The entrant's present value of profits after entry declines due to the incumbent's pairing of tickets, because the technique slows the rate at which customers switch to the entrant.[8]

---

[5] To a greater degree, trading stamps, like discount coupons, allowed the seller to discriminate based on value of the purchaser's time.

[6] See Banerjee & Summers (1987) for a table of the increasing marginal bonus values from increased mileage on frequent flyer programs.

[7] I assume Bertrand competition with constant marginal and average cost. The story is complicated only slightly by declining average costs.

Though this simple model highlights the effect of customer "attachment" with FFP's, it omits institutional details of the programs that seem to be important in their effectiveness. One key to loyalty inducement from FFP's seems to be the extensiveness of the airline's route network. In the 1987 USAir-Piedmont merger case, for instance, the joint applicants argued that their comparatively small route structures and the fact that they offer few attractive "payoff" destinations put them at a disadvantage in the use of FFP's relative to the 6 larger airlines.[9] Though some of these difficulties can be addressed by forming affiliated FFP's, in which many airlines participate in the same program, the transaction, bargaining, and coordination costs of such arrangements are recognized to be substantial.[10]

It has also been widely stated that a primary purpose of these programs is to offer kickbacks on business purchases in the form of a gift to the agent that does the buying for the business.[11]. Though such an incentive might raise a travel-purchasing firm's costs, FFP's also increases the compensation received by its employees. Furthermore, such compensation is not taxed. Thus, one can easily imagine an allocation of costs and benefits from such kickbacks in which the only net loser is the government.[12] Though the kickback aspect of FFP's is easily included in the model presented below, it is shown that even without exploiting such a principal-agent problem, a multi-product monopolist may be able to deter any single-product entry by linking its products through an FFP.

With these features of the programs in mind, I present a model of a simple airline industry in which FFP's are useful in deterring entry. Though the model is quite stylized, it seems likely that the insights from it are more general. I make the following assumptions:

a) An incumbent monopolist serves both of two routes, A and B, each at constant average (equal marginal) cost, C_A and C_B, respectively.

b) There are many customers on route A, each of whom has a positive reservation price for 2 flights per period on the route, R for the first flight and V for the second flight, where $R > V$ and $C_A < V < (R + C_A)/2$.[13] One of the route A customers also travels on route B. She receives positive value from one flight per period on route B, for which she has reservation price R ($> C_B$). The other route A customers make no other trips and no one else travels on route B.

---

[8] Unlike the model presented by Banerjee & Summers (1987), this program does not discourage the incumbent from price cutting, because the firm offers a pre-paid product for next period, rather than a discount off the market price of the good next period.

[9] See, for instance, U.S. Department of Transportation, Docket 44719, USAir-Piedmont Acquisition Case, Exhibit JA-T-1, p. 16-17, May 22, 1987.

[10] See Levine (1987) and USDOT, Docket 44719, JA-T-1, p. 17.

[11] See Borenstein (1983), Levine (1987), and Banerjee & Summers (1987).

[12] This may explain why firms that are large purchasers of air travel, such as IBM and GM, have not objected vehemently to frequent flyer programs. Few firms have implemented strict monitoring of frequent flyer miles acquired by their employees during business trips.

[13] The restriction that $V < (R + C_A)/2$ implies that the incumbent would not find it more profitable to set $P = V$ than $P = R$. The importance that some positive-surplus trips are left unsold without an FFP becomes evident in what follows.

c) At some point in time after the incumbent has established its operations in the industry, a potential entrant appears that could serve route B at constant average cost, C_E, where $C_E < C_B$.

d) There are sunk costs associated with each city-pair market entered, S, which must be paid in the period before entry.

Without an FFP, the incumbent charges $P = R$ in each market until the potential entrant appears. If the potential entrant decides to enter, it charges $P_E = C_B - \epsilon$, where ϵ is an arbitrarily small postive number, and sells one trip on route B each period. The new firm enters route B if and only if

$$S < \frac{C_B - C_E}{i} \qquad [1]$$

where i is the interest rate.

The FFP helps to deter entry by delaying or preempting customers from switching to the lower-price entrant. This, in turn, lowers the present value of the entrant's expected profits and thus, for some levels of sunk cost, will deter entry. The FFP that I posit is not argued to be the optimal one from the point of view of the incumbent, but it is one example of an FFP that has this effect. I assume that:

e) The FFP offered by the incumbent firm awards one free trip after every four that are purchased on the incumbent airline. The bonus is awarded and consumed during the same period as the last trip necessary to earn it. I assume that a bonus trip never "crowds out" an R-valued trip.[14] This assumption is consistent with the kickback aspect of the programs, but does not rely on it. "Blackout" times and dates for use of FFP bonuses, as well as expiration dates for use of the free trips, also lower the proportion of bonus trips that are used for high-value travel.

f) Customers always choose to take their bonus trips on route A. Though this seems restrictive, it is not that unrealistic if one thinks of route A as representing "all other" routes that the incumbent serves.[15]

g) An immediate consequence of the FFP structure is that the customer who flys on routes

---

[14] For people traveling only on route A, this follows immediately from the restriction of same-period use of the bonus. It is an additional assumption for the customer who flys on both routes.

[15] Furthermore, a model with two paying customers on route B, one of whom prefers the bonus on route A and one on route B, yields similar results.

A and B earns the bonus every second period.[16] A customer who has just received the bonus is referred to as "unattached" and one who has some flights towards the next bonus as "attached."

h) Neither firm raises price during a bonus cycle in response to the number of flights that a customer has built up towards her next bonus. This is intended to be the one-customer analog to the fact that there are always some FFP members who have investments towards the next bonus. Alternatively, and perhaps more realistically, buyers could simply believe this to be the case, so that their valuations of future FFP bonuses are made under the assumption that the airline will continue to charge its current prices.

Without entry, the incumbent charges a price higher than R on route A, reflecting the reservation price for the first trip each period, plus the route-A customers' present value of the bonus trip, which is valued at V when taken.[17] Because the incumbent cannot discriminate the customer who also flys on route B from all other route-A customers, it is straightforward to show that the incumbent would not change price on route A if entry occurs on route B. In the absence of entry on route B, the incumbent charges a price above R on route B as well, because the customer who earns the bonus every second period will receive a higher present value from it than those who receive it only every 4th period.[18]

Now consider the result of entry. With probability one-half, the customer has just received a bonus and is unattached. I consider this case first. If the customer chooses to switch to the entrant for her route B flights, she will forego the bonus that she would have received next period and every fourth period following that.[19] The present value of the foregone bonus trips is

$$\begin{array}{c}\text{Present Value of Lost}\\ \text{Bonuses From Switching}\end{array} = \frac{V}{1+i} + \frac{V}{(1+i)^5} + \frac{V}{(1+i)^9} + \ldots = \frac{V}{1+i} + \frac{V}{(1+i)^5 - (1+i)} \equiv V\Delta. \quad (2)$$

where Δ is a discounting factor defined by the last equality. Switching to the entrant, however,

---

[16] The customers who fly only on route A earn the bonus every 4th period.

[17] To be precise,

$$P_A^* = R + \frac{V}{2 + i + (1+i)^2 + (1+i)^3}.$$

This is the price at which the present value of payments over a 4-period frequent flyer cycle equals the present value of the benefits of all flights received during that cycle.

[18] To be precise

$$P_B^* = R + \frac{V}{2 + i + 1/(1+i) + 1/(1+i)^2}.$$

The second term is the additional value of the bonus trip received by the person who obtains the bonus every second period rather than every fourth period.

[19] That is, designating the time of entry as period 1, switching to the entrant will cause her to receive bonuses in periods 4, 8, 12, ... instead of 2, 4, 6, 8, 10, 12, ...

also lowers the incumbent's costs of providing bonus trips. The present value of these cost savings is $C_A\Delta$.

Because of the cost savings from less frequent bonus awards if the customer switches, the incumbent will not be willing to lower P_B all the way to C_B to prevent switching. Instead it will drop only to $P_B = C_B + \frac{i}{1+i}C_A\Delta$, where the term $\frac{i}{1+i}$ converts the present value of the bonus to a perpetual charge beginning this period. The incumbent would prefer to lose the customer rather than to lower price further on route B. Still, the entrant must offer the customer savings with a present value of at least $V\Delta$ in order to induce her to switch. That is, the entrant must undercut the incumbent's price by at least $\frac{i}{1+i}V\Delta$. Two results follow immediately:

Result 1: If the route-B customer is unattached and $C_E > C_B - (V - C_A)\frac{i}{1+i}\Delta$, the FFP prevents profitable entry regardless of sunk costs. If this condition holds, there is no price above C_E at which the entrant could make positive sales. In the subgame perfect equilibrium, no entry occurs. If entry were to occur, there is a unique Bertrand equilibrium in the subgame that follows in which the incumbent charges $P_B = C_E + V\frac{i}{1+i}\Delta - \epsilon$ and makes the only sale in the market.

Result 2: If the route-B customer is unattached and $C_E < C_B - \frac{i}{1+i}(V - C_A)\Delta$, profitable entry will depend on the size of sunk costs, S, but will be less likely than if there were no FFP. If entry occurs, there is a unique Bertrand equilibrium in the subgame that follows in which the entrant charges $P_E = C_B - (V - C_A)\frac{i}{1+i}\Delta - \epsilon$ and makes the only sale in the market. So long as $V > C_A$, the entrant will have to charge a price discretely below C_B and thus the present value of future profits will be less than without the FFP.[30]

Even if an FFP does not prevent an unattached customer from switching to a lower-price entrant, it could still dissuade switching by an attached customer until she becomes unattached. If, in a post-entry equilibrium an unattached customer would buy from the entrant, then her decision to switch while still attached instead of waiting one period would just delay all future bonuses. That is, instead of receiving bonuses in periods $1, 5, 9, \ldots$, where period one is the time of entry, a customer who switches while attached would receive bonuses in periods $2, 6, 10, \ldots$. This delay lowers the present value of future bonuses:

$$\begin{array}{c}\text{Present Discounted Cost of}\\ \text{Switching While Attached}\end{array} = \frac{iV}{1+i} + \frac{iV}{(1+i)^5 - (1+i)} = iV\Delta. \qquad (3)$$

Likewise, retaining an attached customer on route B for one period until she becomes unattached raises the incumbent's present discounted cost of providing bonus trips by $iC_A\Delta$. These cost and value differences will be reflected entirely in the competition during the first period after entry, because all parties know that the customer will switch when unattached. Not surprisingly, it will be more costly for an entrant to induce an attached customer to switch than an unattached customer.

---

[30] The entrant will have to continue to charge P_E as long as the threat from the incumbent persists.

Result 3: If $C_B - i(V - C_A)\Delta < C_E < C_B - \frac{i}{1+i}(V - C_A)\Delta$, an unattached customer could be profitably induced to switch to the entrant, but an attached customer could not be profitable induced to switch until she became unattached. More generally, an attached customer will require a price $(1 - \frac{1}{1-i})i(V - C_A)\Delta$ lower than an unattached customer in order to induce switching.

Though quite simple in its structure, the model suggests a number of insights about FFP's.

– – The FFP is effective, because it allows the incumbent to tie, in a credibly precommitted way, travel on the entered route to another product that is valued more highly by the customer than it costs the incumbent to produce.[21]

– – Not only must the cost of producing the bonus product be less than V for the FFP to be a profitable strategy, the *opportunity* cost of tying it as a FFP bonus must also be less than V. This is more likely to be the case if the V-value trip cannot be sold separately because of either an inability to price discriminate or the elimination of the kickback effect if it is sold directly. If the trip would otherwise not be sold, or would be sold by some other firm, whether on route A or some other "payoff" route (whose price would then determine an upper bound on V), then the FFP may facilitate a Pareto improving trade.[22]

– – The value of the bonus trip V is compared to expenditures on the paid-for trips in making the switching decision. If the shadow value of marginal expenditures on the R-value trips is less than 1, as is the case when the purchasing agent does not fully internalize differences in trip costs, then V is greater than the agent's actual reservation price for the trip and is thus a relatively stronger inducement not to switch. The kickback aspect of an FFP reenforces its entry deterring effect.

– – Because entry on route B would result in a price near marginal cost, $C_E < P_E < C_B$, the entrant would be at a disadvantage in establishing its own FFP to fight back. The only bonus it could offer, a free flight on route B, has an upper bound on its value of P_E. This is true whether the entrant establishes new zero-mileage membership in its own FFP or offers to match the mileage that the customer has built up on the incumbent's FFP. Furthermore, to the extent that versatility in the possible uses of a bonus trip raises its value, the incumbent that offers many flights from the airport will be able to create a greater value-minus-cost differential with its bonus offer than an entrant offering bonus trips on only a single route from the airport.

---

[21] Essentially, this is commodity bundling as explored by Adams & Yellen (1976). In contrast, if $V < C_A$, the FFP increases the cost to the incumbent of preventing switching more than it increases the customers cost of switching.

[22] If the incumbent can price discriminate perfectly, the FFP does not even deter entry if there are "attached" customers. With enough information for first-degree price discrimination, the incumbent could charge an attached customer exactly the gross surplus she derives from the trips the firm provides. In that case, providing the trip on route B adds less to the consumer's gross surplus (the alternative being the entrant's flight at $P_E < C_B$) than it increases the incumbent's production costs. Instead, with entry, the incumbent's best response would be to sell the R-value and V-value trips on route A for prices of R and V, respectively, and to let the entrant provide the trip on route B for $C_B - \epsilon$. If the FFP member wished to take the bonus trip on route B, the incumbent would buy that trip from the incumbent rather than provide the trip itself.

- - If the FFP does not deter entry, some of the customers on the entered route may choose to remain with the incumbent permanently, even though the incumbent always charges a higher price.

Welfare Effects of FFP's

The FFP modeled here has three direct effects. First, it enables the incumbent to bundle products to effect a Pareto improving trade by selling the trip that otherwise would not be sold.[23] Second, it induces customer loyalty by raising the "attached" customers' cost of switching. Third, it sets up a principle-agent problem by paying bonuses to the purchasing agent in exchange for expenditures of the principle's money.

In the absence of an entry threat, the welfare effect of the FFP will depend on whether the surplus gain due to bundling outweighs the (possible) loss from the principle-agent problem.[24] If entry is possible, the FFP may "efficiently" deter it even though $C_B > C_E$, because the sales on the B route also permit Pareto improving exchanges of the bonus trip.[25] The FFP may also allow "inefficient" entry deterrence if switching fails to occur only because marginal expenditures by the principle are not fully internalized by the purchasing agent.

The loyalty induced from "attached" customers can be examined separately from the other two effects. Consider an alternative FFP-like plan in which the incumbent gives a *transferable* coupon to every paying passenger on a flight, with four coupons being exchangeable for a bonus flight. Analysis of the bundling and principle-agent effects differs only slightly from the FFP model presented above.[26] With transferable coupons, however, the effect of "attachment" disappears. Switching to the entrant does not delay future bonuses, because no one holds an inventory of coupons.[27] In steady state, this FFP-like plan gives away the same number of trips each period as the FFP modeled above. This plan, however, does not "attach" customers across periods and, thus, does not allow the credible commitment by the incumbent to maintain some proportion of the traffic after entry. Looking back at the very simple "pairing" model of FFP's presented at the beginning of this Section, transferability of the second ticket in the pair would destroy the advantage gained from such a FFP, as both tickets in a pair would be used in the period of purchase and no commitment by the incumbent for the following period would be credible. From these examples, it is clear that the "attachment" of consumers through an FFP is not critical to their use in effecting potential welfare improvements, but it is central to the role of an FFP as an entry deterrent.

---

[23] This is a Pareto improvement so long as the purchaser's true reservation price for the bonus trip is above C_A.

[24] The principle-agent problem would actually increase surplus if the agent's true reservation value of the bonus trip is greater than C_A. Still, the principle would lose compared to receiving the kickback itself.

[25] This statement takes the structure and terms of the FFP as given.

[26] Ignoring the fact that a coupon system makes monitoring and recapture of kickbacks easier for the principle and that coupon exchange makes it more difficult for the airline to prevent use of the bonus for *B*-value trips, each coupon would have a market value of $V/4$ and each would be used in the same period issued. The entrant would have to undercut the incumbent's price by $V/4$ and would be able to do so only if $C_E < C_B - (V - C_A)/4$.

[27] If a person does not intend to use a coupon in the period of acquisition, it is more efficient to sell it in the competitive coupon market and buy coupons back at the time a bonus trip is desired.

In the full FFP model presented, the multiproduct incumbent has an advantage in part because V is likely to be higher for the bonus the incumbent offers. This raises the welfare improvement from tying and increases the entry-detering effect of "attachment" (note the necessary price differential in result 3). It is worth noting that both of these effects disappear with a FFP-like transferable coupon system. The resulting market in coupons would channel each airline's coupons to the cities where users obtain the highest value from them. Airlines with more extensive systems overall would still have some advantage, but much less than the advantage each carrier currently has in the cities where it dominates service.

III. Other Sources of Market Power Through Airport Dominance

Frequent flyer programs are just one of many devices by which an incumbent airline that dominates traffic in a city may be able to lower the present discounted value of an entrant's profits. In his recent work on competition in the airline industry, Levine (1987) has pointed out many possible barriers to entry, some natural such as transaction costs of leasing gates and the expense of advertising, and some strategic, such as the cost to an entrant of overcoming an incumbent's frequent flyer program or the bias of the computer reservation system used by most of the local travel agents. Levine's views are particularly important, because he has not only studied the industry as an academic, he was also an important decision maker at the CAB in the late 1970's, an executive vice-president of Continental Airlines, and the CEO of New York Air in the early 1980's. His evidence is first-hand if, at points, anecdotal. Furthermore, to the extent that barriers to entry are effective if they are perceived to exist, Levine's views that they exist are important in and of themselves. Finally, his views are, for the most part, shared by top executives at USAir, Piedmont, and America West Airlines.[28]

While frequent flyer programs benefit in their effectiveness from the principal/agent problem between employees and employers, they do not rely solely on this imperfection, as shown in the previous Section. On the other hand, the principal/agent relationship between air travel buyers and travel agents is the sole source of two other potential deterrents to effective entry - - travel agent bias due to commission override programs and information bias from computer reservation systems.

---

[28] In the USAir-Piedmont merger case, the same institutions - frequent flyer programs, travel agent commission overrides and computer reservation systems - were pointed to by the joint applicants as reasons that they needed to merge in order to compete and were argued by America West to be reasons that the merger would make it more difficult for smaller airlines to compete.

Travel agent commission override programs (TACO's) pay bonuses to travel agents who generate some specified level of revenues for the airline. As with frequent flyer programs, the bonuses are usually a nonlinear function of revenues generated. Because the marginal returns are increasing, the programs can effectively "attach" travel agents to certain airlines. The bonuses are generally in the form of increased commissions on marginal sale or free travel for the agent to use himself, or to sell and keep all of the resulting revenue. Such programs, however, work only to the extent that the principal cannot fully monitor the travel agent and costlessly judge the quality of the information that the agent delivers. Of course, the reason that travel agents exist is to lessen the buyer's need to find and process travel information herself. As has been pointed out in the reputation literature, it is rarely profitable for a seller to maintain optimal quality - in this case the travel agent's quality of information - when the buyer cannot monitor perfectly.[29]

Once it is recognized that a principal/agent problem is likely to exist, and thus the travel agent will operate to some extent in his own interest, the model of Section II applies directly. As with FFP's, an airline offering the most opportunities for building up "points" (revenues in this case), and offering the most valued set of bonuses will be most effective in inducing loyalty through a TACO program. These aids to inducing loyalty are likely to favor the airlines with more flights to and from a city.

The bias of computer reservation systems (CRS's) is also effective only to the extent that there are costs in monitoring an agent's behavior. In this case, the agents are the companies that produce computer readouts of flights and fares, all of which are affiliates of at least one major airline. Federal regulators and competing airlines have attempted to lessen strategic use of CRS flight listing by CRS owners through regulation and antitrust prosecution. Still, because the set of data that a CRS must process and make available is enormous, subtle biases are widely believed to persist.[30] Many experts think that elimination of such biases through direct regulation of the CRS displays will be virtually impossible.

The simple fact that an airline owning a CRS will bias the display in favor of its own flights does not necessarily imply that a dominant firm at an airport will have greater advantages. It appears to be the case, however, that in cities dominated by one carrier that owns a CRS, more of the travel agents will use that airline's CRS.[31] In Dallas, for instance, a travel agent will book most flights on American. This is in part due to the fact that American has the most flights there, but also because FFP's and TACO's have effectively induced loyalty from local business travelers and travel agents. It is completely reasonable then for the agent to prefer the CRS that is biased towards the company that the buyer or agent is likely to prefer anyway. Thus, some buyers' (travelers and travel agents) preferences for the local airlines or recognition of the dominance of one airline will lead to choosing that airline's CRS, which will, in turn, further entrench the dominant firm's position. The bias will then exist even when trips are being booked for a traveler who is not an FFP member.

---

[29] See, for instance, Shapiro (1982).

[30] See Levine (1987), and USDOT, Docket 44719, JA-T-1 and JA-T-2. *For a view defending the efficiency of CRS display decisions, see Regulation, January/February 1988.*

Discussions of entry deterrence in the airline industry over the past few years have focused to a great extent on availability of two critical inputs, slots and gates.[32] A slot is the right to have a plane takeoff or land at a certain airport during a certain time period. Gates are physical assets, the building and the jetways that are extended out to airplanes at gates to accommodate enplaning and deplaning passengers. Ownership or control of most of the stock of a critical input in a market can allow an incumbent to block effective entry. When a single airline controls most of the gates at an airport, it may be able not only to refuse to sell or lease facilities to entrants, but also to influence the decision of the airport operator (usually a local government) regarding expansion of the airport to accommodate new entrants.[33] Similarly, at slot-constrained airports – airports that receive more requests to takeoff and land during some hours of the day than they can accommodate – control of a dominant share of the slots can allow an airline to inhibit profitable entry. Such market power must not be confused, however, with price premia that reflect competitive rents to these scarce inputs. A method of diagnosing such scarcity rents is presented in the following Section.

Competition Among Airports

Discussion of entry barriers at airport facilities leads naturally to the question of whether different airports in the same metropolitan area can be used to offer city-pair travel services that are in the same market. Do the Newark-Detroit flights effectively discipline prices on the La Guardia-Detroit flights? In past merger cases and airline analyses, this argument has focused on the standard criterion for judging market boundaries, the cross-elasticities of demand. This approach misses an important aspect of airline competition: the ability to segment demand.

A simple example makes the point. Assume that half of all NYC-Detroit travelers have weak preferences between La Guardia and Newark. Of those with a strong preference, each customer

---

[31] See Levine (1987) for discussion of this point and references to the scant data that exist.

[32] See Levine (1987), *Wall Street Journal* (July 30, 1987), Borenstein (1988), as well as the records in USDOT, Dockets 43825 (Texas Air/Eastern merger, 1986), 43837 (TWA/Ozark merger, 1986), and 44719 (USAir/Piedmont merger, 1987).

[33] For anecdotal evidence of such behavior, see *Wall Street Journal* (July 30, 1987) and USDOT, Docket 44719, AWA-T-1.

prefer's one airport or the other, half preferring each airport. Weak-preference travelers flock to the airport at which prices are lower. In the absence of the ability to segment demand, this large group of marginal travelers would, quite likely, cause competition between service at the two airports to be fierce, also benefiting the travelers who have strong preferences and would not switch.

If, however, the group with strong airport preferences, *i.e.*, travelers with high time values, can be segmented, competition among airports for the customers willing to switch need not discipline the prices charged to those with strong preferences.[34] Restricted discount fares are probably quite effective in sorting customers by their time values. Thus, we would expect to see the presence of competing metropolitan airports affect the fares charged to people with low time values, those who generally fly on deep discount fares, more than the full fare travelers. In the empirical work presented here, flights to different airport are considered to be in separate markets for the purpose of market share calculations. The degree of actual substitutability remains for future work.[35]

IV. The Data and Estimation Techniques

The central hypotheses that I test in this paper are that, controlling for differences in cost and in the market demand for different routes, a carrier charges higher prices (a) when it carries a higher proportion of the traffic on a route and (b) when it has a higher share of the enplanements at the origin and destination airports of a route. If (a) is found to be true, as has been the case in previous work,[36] this can be interpreted as evidence that airline markets are not perfectly contestable. Given the weight of evidence from previous studies, it would be quite surprising if this were not found to be the case. Still, only one of the previous works has considered simultaneously the effects of actual and potential competition. Those that omit measures of potential competition may be attributing the effects of dominance at the endpoints of a route to the share of traffic actually carried on a route. If (b) is found to be true, this is evidence that some or all of the factors discussed in the previous Sections may allow airlines to maintain greater market power on routes to or from airports at which they have a comparatively large presence.

The approach to measuring these effects is similar to earlier studies of airline pricing. I estimate a pricing equation as a function of costs, market demand parameters, and factors that are hypothesized to influence a carrier's market power. There are some differences, however, that may make it likely that the results of this analysis will be more reliable (less bias) and more accurate (smaller standard errors) than previous works. First, whereas earlier works have used relatively small samples, less than 1000 routes in nearly all cases,[37] I use the entire Origin and Destination Survey, which is a 10% random sample of all domestic tickets issued, for itineraries wholly contained in the 200 largest airports in the U.S.[38]

---

[34] Borenstein (1985) presents such a model of price discrimination when buyers are heterogeneous in their costs of brand switching.

[35] For anecdotal and some rough empirical work on this subject see testimonies in USDOT, Dockets 43825 (Texas Air/Eastern merger, 1986) and 44719 (USAir/Piedmont merger, 1987).

[36] See, Graham, Kaplan, & Sibley (1983), Bailey, Graham, & Kaplan (1985), Call & Keeler (1985), Moore (1986), and Morrison & Winston (1987).

Second, none of the earlier works has attempted to estimate costs per passenger directly. Most have used origin to destination distance or the Civil Aeronautics Board's Standard Industry Fare Level (SIFL). Admittedly, until a thorough understanding of network economies is attained, estimation of per-passenger costs will be unreliable. Still, both measures that have been used are quite simplistic, the SIFL being just a nonlinear function of origin to destination distance. They take no account of load factor, average length of haul (takeoff to landing distance), total routing mileage, size of aircraft used, or possible technical production economies from hub operations (as distinct from hub economies due to the attainment of higher load factors). I take these other factors into account (along with mileage), nearly all of which are significant in the estimation. Though this is certainly not an exhaustive list of cost determinants, it still seems likely to more accurately reflect costs than the simple mileage-based estimates.

Third, I have attempted to incorporate the effect of the most important quality of service variables. Interpretation of the coefficients of these variable – number of plane changes, number of on-plane stops, circuity of routing, and frequency of service – is complicated by the fact that they reflect cost as well as product quality determinants. Nevertheless, the inclusion of these factors makes it less likely that the estimates of the market power variables are seriously biased.

Fourth, unlike any of the previous studies, I have not pooled the sample across airlines. In fact, Chow tests of pooling among all airlines, as well as pairwise pooling between airlines, has rejected any such pooling. This is not surprising given that I have not included input costs, which vary widely across carriers, in the regressions and that I probably could not effectively quantify differences in marketing strategies or management efficiency. By omitting such factors, I am still assuming that they are constant within each airline. This misses some of the determinants of pricing, to be sure, but is far less restrictive than assuming that these factors are constant across firms.

Fifth, I attempt to measure not just the presence of potential competitors on a route, but the competitive threat that they actually pose. Consistent with the discussion of frequent flyer programs, as well as travel agent commission overrides, foreclosure of input markets and other factors, an airline's insulation from potential competitors at the endpoint airports is modeled as depending on the airline's share of total enplanements at the endpoint airports. Previous studies that have tried to incorporate potential competition have used as a measure the number of carriers serving the route endpoints, regardless of the size of carriers' operations at the airports.[39] At each of the largest airports in the U.S., however, most of the 11 major airlines have some operations. Using the competitor-counting approach, American Airlines with 63% of the enplanements at Dallas/Ft. Worth would be seen to be under considerable pressure from potential competition, because 18 other domestic airlines operated at least one flight per day from there in the second quarter of 1986. In fact, there would be no distinction between American's position at DFW and its position at San Francisco, where American has 7% of the enplanements and 18 other carriers operate. The threat of potential competition would be symmetric among all airlines at an airport regardless of their differences in size, a hypothesis that is not supported by Table 1.

---

[37] The exception is Bailey, Graham & Kaplan (1985), which studies more than 5000 city-pair markets.

[38] The exclusion of tickets that include airports outside the top 200 eliminates fewer than 1% of the domestic passengers in the survey. The sample used here includes more than 1.9 millions tickets and more than 73,000 unique airline/itinerary observations.

Sixth, the estimation allows separation of the effects on fares of market power due to airport dominance from the effects due to scarcity rents at crowded airports. Furthermore, scarcity rents are estimated for all of the 23 most crowded airports, not just the 4 at which the FAA has explicitly divided and allocated the property rights to landing slots. Though previous works have analyzed these effects at the 4 slot-constrained airports, the scarcity problems exists at many others.

Seventh, I analyze not just the average fare charged on a route, but also the 20th percentile fare paid, and the 80th percentile fare paid. By doing this, one can get some idea of the differential effects of the right-hand side variables on the price of the low-end tickets and the price of the high-end tickets.

The Sample

Details of the data sets and the construction of each variable are given in the appendix. This Section gives a general description of the sample.

The basis of the sample is two data sets collected by the Department of Transportation for the second quarter of 1986. The Origin and Destination Survey is a 10% random sample of all tickets sold in the U.S. The data set contains most of the information found on a normal airline ticket – all cities of enplanement or deplanement, the price of the ticket, the carrier for each flight on the itinerary, and the fare code.[40] The survey does not include flight numbers or date/time of a flight. A single record in the survey includes all tickets that fall into a unique carrier(s)/itinerary/fare category. Thus, for instance, one record might indicate that 417 people in the 1986:2 survey flew JFK-STL-LAX-STL-JFK on TWA and paid $290. Each record also distinguishes which cities are directional breakpoints, *i.e.*, terminations of travel in a direction, as opposed to just change-of-planes stops. On-flight stops are not shown.[41]

---

[39] Of those listed in footnote 36, only Morrison & Winston (1987) consider the effect of potential competition. Peteraf (1986) studies prices on monopoly airline routes. As a measure of potential entry, she uses the ratio of the monopolist's enplanements at the endpoints to the enplanements of the largest potential competitor. The results are generally insignificant.

[40] The fare code is rather arbitrary and is considered useful only to distinguishing first-class from coach seats.

In the regressions presented, each observation is formed by aggregating all records that have the same airline and itinerary, but different fares. All interline tickets, (*i.e.*, those including more than one airline) and all tickets that include some international travel or some travel in first class were removed from the sample.[42]

The second data set used is the Service Segment Data. This is not a survey, but a complete census of all flights for the largest airlines. It contains no price data, the unit of observation being a flight number (though the flight numbers themselves are not reported). For each scheduled (and unscheduled) flight number of an airline, the data set includes the total number of seats available during the quarter, the number of people who enplaned at each city and, of them, the number that deplaned at each downline point.

Functional Form

Profit maximization by a firm with market power implies that price will be proportional to marginal cost and the inverse of the elasticity of demand faced by the firm. Previous studies of airline pricing have thus estimated markup equations using a multiplicative functional form.[43] This form imposes constant elasticities on the effect of the independent variables on fares.

Because I explicitly estimate the effects of a number of cost variables, rather than using the SIFL or the origin to destination route distance as a proxy for cost, the multiplicative function is somewhat more questionable in this case. Some cost factors may, in fact, enter additively into the cost structure. For instance, the cost of ticketing a person and loading his baggage is to a large extent independent of the distance flown or what the price of the ticket would otherwise be. More generally, even if certain variables such as the measures of market power do enter multiplicatively, there is no good reason to believe that the elasticity of the price with respect to these variables is constant.

It seems particularly unlikely that the effect on fares of an airline's enplanement share or route share changing from 1% to 2% is the same as the share increasing from 30% to 60%. For this reason, the airline share variables and the variables measuring the concentration of all other airlines in the airport or route market are entered in levels, rather than their natural logarithms.[44]

---

[41] The glossary at the end of the appendix gives more precise definitions of the terms used to describe an itinerary.

[42] Prices of interline tickets are governed by idiosyncratic bilateral agreements and are unlikely to be determined in the same way as airlines set prices for flights wholly within one firm.

[43] See Graham, Kaplan, & Sibley (1983), Bailey, Graham & Kaplan (1985), and Peteraf (1986).

[44] Thus, for example, every percentage point increase in airport share is assumed to have the same proportional effect on prices

Since the true model, if a consistent one actually exists, is probably highly non-linear and is certainly not known with any degree of confidence, as much sensitivity analysis as is possible and affordable is called for. Because of the size of the data set and number of right-hand side variables, I have not attempted estimation by any iterative methods. In discussing the results, I focus on what seem to be the most reasonable specifications of each variable, given the constraint of linearity in the parameters. Regressions that employ alternative specifications are also summarized in the tables.

Diagnosing Scarcity Rents at Congested Airports

Higher prices at a given airport might indicate market power, but if there is excess demand for gate or runway use at the airport, the prices could also reflect scarcity rents to those fixed factors.[45] These rents can be distinguished from the market power available to a dominant airline, however, because the effect of scarcity rents on the price of flights will be the same for all airlines operating at an airport.[46] In contrast, market power, as reflected in a carrier's share of airport enplanements, will differ among the airlines at an airport.

Scarcity rents are thus identified and separated from airline-specific market power at an airport by estimating airport specific effects on price that are restricted to be the same across airlines. This technique allows examination of not just the four airports at which the FAA has established slot allocation mechanisms (O'Hare, JFK, La Guardia, and Washington National), but also other airports that are congested, but operate under "flow control."[47] The FAA monitors 22 airports for congestion problems.[48] I estimate airport-specific price effects for these 22 plus John Wayne Airport in Orange County, California, which is under strict local limits on takeoffs and landings.

Though the airport operation variables (*e.g.*, the number of takeoffs and landings at O'Hare airport that are part of a given itinerary) restricted across airlines will separate scarcity rents from airline-specific market power due to airport share, they will also capture to some extent the effects of airport concentration on the prices of all carriers at an airport. That is, if there is an "umbrella" effect from concentration that lets even smaller carriers raise prices, these market power effects will be reflected in the airport operations variables.[49] Thus, the parameter estimates for these variables may be only upper bounds on the scarcity rents.[80]

---

[45] Similarly, higher prices at an airport might reflect other high (opportunity) costs, such as higher local fuel prices, wage rates, etc.

[46] If all routes from an airport are competitive, scarcity rents for the marginal unit of output (flights) will necessarily be equalized across uses of the slots or gates. In fact, even for inframarginal flights, the effect of scarcity rents on *price* would be the same. Though scarcity rents would be greater for inframarginal uses of the fixed factor than for marginal uses, if all uses were in competitive markets, the differences in scarcity rents would result from lower production costs, not higher markups, in some applications of the fixed factor.

[47] Flow control is essentially a first-come, first-served allocation system, which often leads to planes queuing for takeoff.

[48] See U.S. Federal Aviation Administration (1987).

[49] This is true to only a limited extent, because the airport variables used count all operations at an airport that are part of

Scarcity rents due to shortages of airport capacity should impose the same cost regardless of the route the plane is flying, so these rents should be estimated as additive factors, such as a $5 price increase for every takeoff or landing at O'Hare airport, not multiplicative factors. That nonlinearity, however, would require iterative methods that would be prohibitively expensive. Still, estimation in multiplicative form (log-linear) would cause a larger price increase for longer and more expensive flights than for short flights. As a partial solution to this problem, I use as the scarcity variables the number of operations at an airport divided by the direct-routing distance (in thousands of miles) of the itinerary.[81] Thus, the scarcity rent effect on price is estimated to be a multiplicative effect of operations at a given airport *per thousand miles of travel.*

Estimation Technique

The regressions that are presented contain two right-hand side variables that are likely to be endogenous, and thus would be correlated with the error term if estimation were done by ordinary least squares (OLS). An airline's price on a route is likely to affect its load factor and its share of the traffic on the route. For this reason, the equations are estimated by two-stage least squares (2SLS).

Identifying the effect of load factor requires a variable that is correlated with the actual load factors on the flights on which the passengers in an observation travelled, but is not causally influenced by the price charged to those passengers. Essentially, the identifying variable used was the proportion of aircraft capacity filled by people who were flying on the same plane as those on a given airline/itinerary, but who were on different itineraries that were not affected by the price in the observation. For instance, a passenger traveling nonstop Los Angeles to Denver will be on a plane with people who will connect in Denver to other flights that will take them to their final destination and, perhaps, with people who will continue on the same plane to a point beyond Denver. The number of people choosing to make these other trips will not be strongly influenced by the price charged to the Los Angeles-Denver passengers. The exact construction of the identifying excluded exogenous variables is described in the appendix.[82] The fitted load factors then functioned

---

an itinerary (excluding on-flight stops), regardless on whether the airport was the ticket origin, a directional destination, or just a change-of-plane stop. A similar variable for measurement of the effect of concentration on price would exclude airports that are only change-of-plane stops.

[80] The airport operations variables will also reflect the presence of a low-cost airline at an airport that might lower all prices at the airport due to the threat of its entry or its actual competition. This probably explains the negative estimates for Denver (DEN) and Newark (EWR) where low-cost airlines (Continental and Peoples Express) were very influential during the second quarter of 1986.

[81] Estimation of the effect as multiplicative, *i.e.*, using just the number of operations at an airport as the independent variable, yields similar conclusions for the route share and airport share effects, but the results for some airports do change noticeably.

[82] These identifying variables may still suffer some endogeneity to the extent that a low price for one itinerary may fill many seats and crowd out those who wish to fly on the same plane as part of a different itinerary. If there was no such

as the excluded exogenous variables in the first stage of the 2SLS estimation.

The omitted exogenous variables used to identify the route share variable are the carrier's share of nonstop and direct service on the route (as measured by available seats) and the number of enplanements by all other carriers at the endpoint airports, entered as both the average number of enplanements by all other airlines at the endpoint airports and the minimum (over the endpoint airports) number. All three variables were highly significant in the first-stage regressions.[53]

Each airline/itinerary observation in the sample represents a different number of passengers. Passengers on the same airline/itinerary, however, are clearly not independent observations, so the standard correction for frequency-categorized data, weighting by the square root of the number of people in an observation, would be inappropriate.[54] Airlines choose to offer a menu of fares with varying restrictions and, by doing so, determine the average fare (as well as the 20th and 80th percentile fares) that they charge for an itinerary. This argues for treatment of each observation identically, regardless of the number of passengers it includes. Quite a few observations, however, are for unusual (as a proportion of all travelers) routings that represent only 1 or 2 passengers. The results on which I focus omit these observations, which constitute about 52% of all observations and 5% of all passengers.[55]

V. Results and Interpretation

The results of regressions for the 11 largest domestic airlines are reported in Tables 2 through 7. Tables 2, 3, and 4, present the parameter estimates using as the dependent variable the average fare (log), the 20th percentile fare paid (log), and the 80th percentile fare paid (log), respectively. Table 5, presents reduced form estimates of the equations, with the identifying excluded exogenous variables substituted for the edogenous right-hand side variables.[56] The last column of each of these tables presents the weighted averages of the parameter estimates over the 11 airlines and the standard errors of these averages. The weight for each parameter estimate in the average is the

---

endogeneity, then the load factor on a flight could be estimated as simply the sum of the estimated load factors due to each type of passenger, *i.e.*, the regression of total load factor on the load factor due to a certain group of passengers would yield a parameter estimate of one. In fact, in the fitting regressions, the coefficients on the right-hand side variables were generally less than one (usually around 0.9) and in a few cases statistically different from one.

[53] The standard errors reported are asymptotic standard errors corrected for the 2SLS procedure. That is, the estimate of σ^2 is calculated using the parameter estimates and the actual route share and load factor variables.

[54] Using the average fare as the dependent variable and weighting each observation by the square root of the number of passengers in the observation yields parameter estimates that are numerically identical to those that would result from treating each passenger as a separate observation. The standard errors, however, are understated in this case versus treating each individual as a separate observation, because the within-itinerary fare variation is eliminated by using the average fare as the dependent variable.

[55] The central conclusions discussed are supported more strongly if these observations are included. The results are somewhat weaker if the observations are weighted by the square root of the number of passengers in an observation. These regressions are summarised in the Table 6.

[56] Implicit in these reduced form equations is the assumption that the excluded exogenous variables used as instruments in the 2SLS estimation are the only ones in the structural equations for the other endogenous variables (RTSH and LDFI) that are not included in the structural equations for the fare variables.

inverse of the variance of the parameter estimate.[57] The averages are presented to give an overview of the results, not to make a precise statement about the true parameters in an industry-wide model. As noted above, tests for common parameters between firms have in every case rejected that hypothesis. The average parameter estimates that result possible alternative specifications and data sets are shown in Tables 6 and 7 (omitting the estimates of airport-specific effects). Table 8 gives concise definitions of the variables. Below, I discuss prior beliefs about the parameter values and how they comport with the results.

MILE (log) and MILD (log) - MILE is the total trip mileage on an itinerary, while MILD is the sum of the nonstop origin to destination mileages for each directional segment of the trip ($MILE \geq MILD$). As one would expect, the sum of the coefficients on MILE and MILD is positive, but less than one, indicating that as the origin-to-destination trip length increases the fare increases, but less than proportionally. The positive coefficient on MILE indicates that, controlling for load factor, number of stops and number of plane changes, the additional cost of a person flying greater circuity overrides the associated negative quality effect in inconvenience that lowers the value of the product.

ENPL (log) - This variable is intended to reflect the possible technical economies of hubs. At an airport where an airline enplanes many passengers, the baggage handlers and other personnel can be used more efficiently, lowering per-passenger costs of ticketing, baggage handling and other services. In that case, one would expect the sign of this variable to be negative. It is positive in most cases and on average.

EQP5 (log) - EQP5 is the average number of seats on the planes flown by passengers on a given itinerary, if the average haul length (takeoff to landing distance) on the itinerary is greater than 500 miles. It takes on the value zero (in log) if the average haul length is less than 500 miles. On flights of greater than 500 miles, larger equipment has a lower per-seat-mile cost and therefore would be expected to lower the cost of providing air travel where it is used.[58] On the other hand, the quality of the product is higher in that larger planes are generally more comfortable and are thought to be safer.[59] This might increase demand for the product and, thus, increase the price. The latter effect effect seems to dominate in the results.

LDFI (log) [endogenous], LDFF (log) [exogenous] - LDFI is the average load factor on flights included in the itinerary. LDFF is the fitted value used as an identifying instrument, the construction of which is described in the appendix. Load factor may affect fares in two ways. As load factor on flights increases, the per-passenger cost of the flight declines, thus possibly lowering fares. On the other hand, flights with high-load factors more often fly full and are more likely to operate at peak demand times. The opportunity cost of aircraft in use on a specific route is higher during these times, possibly increasing fares. The former effect seems to dominate. It is offset by the latter effect to a greater extent for low-end fares than for high-end fares. The number of deep-discount seats available seems likely to be decreased on flights that often operate full or during peak demand periods. This differential effect may reflect the greater disutility that business travelers receive from what Douglas & Miller (1974) termed stochastic delay, *i.e.*, the probability that no seat will be available on one's preferred flight.

---

[57] This is identical to running OLS on a constant to calculate the mean, but adjusting the regression for heteroskedasticity due to imprecision (with a known variance) in measurement of the dependent variable. This approach downweights estimates that are particularly noisy.

[58] See Bailey, Graham & Kaplan (1985), p. 81.

[59] Existence of a quality enhancement effect is demonstrated by the frequent mention of "spacious" or "comfortable" wide-bodied aircraft in airline advertisements.

STOP and CHPL - The number of on-plane stops (STOP) and plane changes (CHPL) each have two important and opposite effects on price. Holding constant load factor and mileage, increased stops and plane changes increase the airline's costs of a trip by reducing the average length of haul (takeoff to landing distance). At the same time, they decrease the quality and willingness to pay for the product. The net effect appears to be positive, indicating the the cost effect dominates, though the magnitudes of these (net) effects seem to be quite small.

TOUR (log) - This variable is a proxy for the proportion of tourist travel on a route. As expected, greater tourist travel leads to lower prices. The effect is stronger for the high-end prices than for the low-end prices. If a route is primarily discretionary travel, it appears that the carriers do not lower their deep-discount fares very much, but they do make more tickets available at the moderate discount and "supercoach" (unrestricted discount) fares.

FREQ (log) - This variable is the average number of daily departures offered by the airline on the airport-pairs flown as part of the itinerary. Routes with very high flight frequency will have lower per-flight costs, controlling for load factor, because aircraft utilization (hours per day) is generally greater for the aircraft used on such routes.[60] Of course, greater flight frequency also lowers frequency delay, as defined and investigated by Douglas and Miller (1974), thus increasing the value of the product. This effect will be greater for those who value their time more highly, presumably people who pay the higher fares. The latter effect seems to have somewhat more impact than the former, but the result is not very robust.

Scarcity Rent Variables - These airport operation variables indicate positive and mostly significant scarcity rents at most of the congested airports, with the largest estimates at O'Hare and Atlanta, the the two airports that handle the most traffic in the U.S. The rents are also estimated to be larger for the high-end fares than for the low-end fares.[61] This is to be expected since the scarcity is for gate or runway access for entire planes; the scarcity costs are allocated in greater proportion to the business travelers than to the discount flyers.

---

[60] See transcript of oral testimony of Randall Malin, Vice-President of USAir in USDOT, Docket 44719.

The Effect of Route and Airport Share on Fares

In general, the effect of both route share (RTSH) and average endpoint share (EPSH) on price is positive, as expected. These variables are also generally (and, on average) positive when they are entered in log form (implying constant elasticities, see Table 7). In the structural equations, at least one of the two variables is significantly positive for every firm and both are significant for most firms. In the reduced form equations, EPSH is very significant statistically and in magnitude for every airline. For example, the average reduced-form parameter estimate for the effect of EPSH on average fare (LPRAV, Table 5) implies that a 10% increase in the average endpoint enplanement share for an itinerary would lead to a 4.2% increase in average fare.

The market power afforded by both high route share and high endpoint share has a *proportionally* greater effect on the high-end fares than on the deeper discount fares. This is consistent with the model of Section II that indicated that a dominant carrier may be able to maintain permanently higher fares and still attract customers with its frequent flyer program. The people who fly on high-end fares are much more likely to be FFP members than those who get deep discount prices.

Unfortunately, the data are not yet available to determine how much of a dominant carrier's fare premium is offset by the value of the frequent flyer bonuses it awards. Still, it seems quite unlikely that this could substantially explain the airport dominance effects observed here. On average, the value of a bonus is less than 10% of the fares paid in building up the mileage to obtain the bonus.[62] Thus, even if every mile of travel from an airline's dominated airport resulted in FFP bonuses and none of the other travel on the airline was "cashed in" this would explain only a portion dominated airport fare differential. In fact, more realistic calculations would probably indicate that this additional value from FFP bonuses could account for at most a few percentage points in fare differences. Furthermore, it seems unlikely that the value of FFP bonuses would have much effect on the willingness-to-pay of travelers flying on deep discounts. They are probably much less likely to be FFP members or to cash in mileage, so one would expect very little effect of airport dominance on the low-end fares. Nonetheless, even if the real value of FFP bonuses is comparativley small, their loyalty-inducing effect could be much larger if the kickback aspect of these programs plays a significant role.

---

[61] These are multiplicative factors, so the same parameter estimate for the low-end and high-end fares would imply a higher dollar premium on the high-end fares.

[62] Banerjee & Summers' Table 1 from June, 1986 data indicates, for example, that the largest bonus on United's FFP required 150,000 miles of travel and was valued by brokers of these bonuses at between $2000 and $2800. United's average yield for flights to or from Chicago was 14.8¢, indicating an average payment of $22,000 for the necessary mileage for a Chicago-based FFP member to obtain this bonus. The bonus then is worth between 9% and 12.6% of the fares paid. Similar calculations for other United bonuses and for other airlines generally yield somewhat smaller percentages. These calculations give an upward biased estimate to the extent that discounting is ignored (fares are paid well before the bonus is received) and FFP members probably pay a higher average fare than passengers as a whole. The percentage is biased downward to the extent that private valuations of these bonuses may be greater than the amount that brokers are willing to pay.

The variables RTHO and EPHO are included to represent the concentration of all other route traffic and endpoint enplanements, respectively. In each case, Herfindahl indices are calculated using as the total market the traffic or enplanements of all carriers other than the one in the observation. These are then averaged over, respectively, all the directional segments or endpoint airports included in the itinerary. Thus, these variables address the question how one airline's prices are affected by the concentration of the business that it does not get.

The effects discussed in Sections II and III would indicate that an airline would like its competition to be many very small firms rather than one larger one. On the other hand tacit or explicit coordination among competitors that allows a reduction of competition is less costly and more likely to succeed when there are few competitors to include. The net effect appears to be, on average, positive, but small for route concentration and endpoint concentration.

VI. Conclusion

Public policy towards airlines since deregulation has been premised to a great extent on the contestability of city-pair or airport-pair markets. There is mounting evidence, to which this work contributes, that contestability does not accurately describe the dynamics and competitiveness of the commercial aviation industry. It is quite possible that some of the institutions that have come into existence since deregulation have served to lessen contestability. Frequent flyer programs, travel agent commission override bonuses, and the biases due to computer reservation systems have all been pointed out as new barriers to competition. As the movement to hub-and-spoke networks in the industry has brought greater airport dominance to some airlines, these marketing devices may have increased a dominant carrier's ability to exercise market power at its hub. Other sunk costs of entry, such as advertising and setup of new airport facilities, may also play important roles in lessening contestability.

The empirical work presented does not allow one to determine the extent to which each of these facets of the markets allows an airline with dominant endpoint share to raise price. The results do give a very strong indication, however, that a high share of traffic at an airport will lead a carrier to charge higher fares on the routes to and from that airport. With more precise data about gate and slot control, the extent of frequent flyer and commission override programs, and the usage of different CRS systems, each effect may yet be identified. In the mean time, public policy towards mergers and other questions of airline competitiveness must still be made.

Though the link between airport dominance and high fares seems clear, a welfare analysis of increased airport concentration must also include the benefits that may accrue from hub operations.[63] There may be cost savings that are not fully passed along to consumers, but still increase total surplus in the form of profits. Greater flight frequency, easier connections and more nonstop flights may also be associated with these route systems. In this regard, the estimated impact of these quality factors on price, presented in the previous Section, cannot be interpreted as hedonic prices.[64] These possible benefits of mergers or other increases in airport shares should be weighed against the higher prices that seem likely to result.

---

[63] Carlton, Landes, & Posner (1980) propose one approach to analyzing some of these benefits.

[64] Obviously, the simultaneous effect of these factors on costs confuses the analysis. Even if that were not the case, however, Spence (1975) demonstrated that a firm with market power will make the quality/price tradeoff only so as to reach a Pareto optimum with the marginal consumer. If, as is probably the case in airline travel, inframarginal buyers value quality improvements more than marginal buyers, then the parameter estimates, though a reflection of the marginal buyer's valuation, would underestimate the average buyer's valuation of quality.

REFERENCES

Adams, W. James and Janet Yellen (1976). "Commodity Bundling and the Burden of Monopoly," *Quarterly Journal of Economics*, August.

Bailey, Elizabeth E., David R. Graham, and Daniel P. Kaplan (1985). *Deregulating the Airlines*, Cambridge, MA: MIT Press.

Bailey, Elizabeth E. and Jeffrey R. Williams (1988). "Sources of Economic Rent in the Deregulated Airline Industry," *Journal of Law and Economics*.

Banerjee, Abhijit and Lawrence H. Summers (1987), "On Frequent Flyer Programs and Other Loyalty-Inducing Arrangements," unpublished manuscript, August.

Borenstein, Severin (1983). *Price Discrimination in Free-Entry Markets*, unpublished Ph.D. thesis, M.I.T., June.

Borenstein, Severin (1985). "Price Discrimination in Free-Entry Markets," *Rand Journal of Economics*, Autumn.

Borenstein, Severin (1988). "On the Efficiency of Competitive Markets for Operating Licenses," *Quarterly Journal of Economics*, May.

Call, Gregory D. and Theodore E. Keeler (1985). "Airline Deregulation, Fares, and Market Behavior: Some Empirical Evidence," in A.F. Daughety ed., *Analytic Studies in Transport Economics*, Cambridge: Cambridge University Press.

Carlton, Dennis W., William M. Landes, and Richard A. Posner (1980). "Benefits and Costs of Airline Mergers: A Case Study," *Bell Journal of Economics*, Spring.

Douglas, George W. and James C. Miller III (1974). *Economic Regulation of Domestic Air Transport: Theory and Policy*, Washington, D.C.: Brookings.

Graham, David R., Daniel P. Kaplan, and David S. Sibley (1983). "Efficiency and Competition in the Airline Industry," *Bell Journal of Economics*, Spring.

Ippolito, Richard A. (1981). "Estimating Airline Demand with Quality of Service Variables," *Journal of Transport Economics and Policy*, January.

Levine, Michael E. (1987). "Airline Competition in Deregulated Markets: Theory, Firm Strategy, and Public Policy," *Yale Journal on Regulation*, July.

Moore, Thomas G. (1986). "U.S. Airline Deregulation: It's Effect on Passengers, Capital and Labor," *Journal of Law and Economics*, April.

Morrison, Steven A. and Clifford Winston (1986). *The Economic Effects of Airline Deregulation*, Washington, D.C.: Brookings.

Morrison, Steven A. and Clifford Winston (1987). "Empirical Implications and Tests of the Contestability Hypothesis," *Journal of Law and Economics*, April.

Peteraf, Margaret A. (1986). "The Effects of Potential Competition on Market Performance in

Monopoly Airline Markets," unpublished manuscript, November.

Schwartz, Marius (1987). "The Nature and Scope of Contestability Theory," *Oxford Economic Papers*.

Shapiro, Carl (1982). "Consumer Information, Product Quality, and Seller Reputation," *Bell Journal of Economics*, Spring.

Spence, Michael (1975) "Monopoly, Quality, and Regulation," *Bell Journal of Economics*, Autumn.

U.S. Federal Aviation Administration, "Air Traffic Activity and Delays: Report for October 1987," mimeo, November, 1987.

"Airline Reservation Systems: Curse of the Mummy's Tomb," *Regulation*, January/February, 1985.

"An Unexpected Result of Airline Decontrol is Return to Monopolies: Big Carriers Are Dominating Nation's Hub Airports; Legislators are Concerned," *Wall Street Journal*, July 20, 1987, p. 1,6.

TABLE 1

FARES TO/FROM AIRLINE-DOMINATED AIRPORTS

AIRLINE	HUB	ENPLANEMENT SHARE AT AIRPORT	OTHER AIRLINES AT AIRPORT	AVERAGE YIELD TO/FROM HUB (cts/mi)	AVERAGE YIELD THROUGH HUB (cts/mi)	AVERAGE YIELD NON-HUB (cts/mi)	AVERAGE LOAD FACTOR ON HUB FLIGHTS	AVERAGE LOAD FACTOR ON NON-HUB FLIGHTS	AVERAGE HAUL LENGTH TO/FROM HUB	AVERAGE HAUL LENGTH THROUGH HUB	AVERAGE HAUL LENGTH NON-HUB
American	DFW	61.8%	18	14.9	9.5	11.5	69.7%	64.5%	1053 mi	968 mi	1405 mi
USAir	PIT	82.3	9	21.4	13.8	17.2	63.4	56.5	877	608	587
Delta	ATL	54.2	13	21.6	15.4	13.7	60.6	56.6	972	722	923
Eastern	ATL	39.4	13	18.5	13.0	12.1	58.3	59.2	843	672	985
Northwest	MSP	41.7	14	12.9	8.5	10.3	54.5	62.7	1041	939	1369
Piedmont	CLT	78.6	9	21.0	14.9	17.1	66.4	58.0	668	476	511
Republic	MEM	73.2	6	21.0	14.9	15.8	61.3	59.8	842	635	915
TWA	STL	57.1	15	14.3	8.3	10.8	63.3	48.1	1146	982	1828
United	ORD	44.7	18	14.8	8.3	9.1	69.6	67.1	1196	1191	1221
Western	SLC	74.3	9	15.9	8.2	9.8	62.7	58.7	1322	819	1549

AIRLINE	HUB	AVERAGE YIELD TO/FROM HUB (cts/mi)	AVERAGE YIELD OF OTHER MAJOR AIRLINES AT HUB+ (cts/mi)	AVERAGE LOAD FACTOR ON HUB FLIGHTS	AVERAGE LOAD FACTOR OF OTHER MAJOR AIRLINES AT HUB+	AVERAGE HAUL LENGTH TO/FROM HUB	AVERAGE HAUL LENGTH OF OTHER MAJOR AIRLINES AT HUB+
American	DFW	14.9	13.5	69.7%	57.6%	1053 mi	858 mi
USAir	PIT	21.4	12.6	63.4	55.3	877	912
Delta	ATL	21.6	14.2	60.6	56.4	972	849
Eastern	ATL	18.5	14.2	58.3	56.4	843	849
Northwest	MSP	12.9	13.7	54.5	61.1	1041	842
Piedmont	CLT	21.0	16.2	66.4	53.4	668	814
Republic	MEM	21.0	19.1	61.3	47.3	842	634
TWA	STL	14.3	12.5	63.3	60.1	1146	766
United	ORD	14.8	15.8	69.6	61.4	1196	882
Western	SLC	15.9	10.1	62.7	54.5	1322	1118

+ "Other Major Airlines" includes are all others listed in this table. Both Delta and Eastern are excluded from "Other Major Airlines" data at Atlanta.

Source: Department of Transportation Origin & Destination Survey, Databank 1A, 1986q2
Department of Transportation ER-586 Complete Service Segment Data, 1986q2.

Notes: Yield calculations based on nonstop origin to destination mileage.
Averages of Yield, Load Factor and Haul Length are weighted by passenger-miles.

TABLE 2

STRUCTURAL EQUATION DEPENDENT VARIABLE: LPRAV OBSERVATIONS: 73062 R-SQUARED: 0.6376

AIRLINE	AA	USAIR	CO	DL	EA	NW	PI	RC	TWA	UA	WA	AVERAGE
INTERCEPT	1.9049* (0.1555)	-0.0901 (0.1591)	1.3157* (0.1660)	0.5421* (0.1929)	1.9354* (0.1582)	1.2690* (0.1790)	0.6844* (0.1364)	1.4555* (0.2478)	1.3490* (0.3673)	-0.2505+ (0.1151)	1.6805* (0.2114)	0.8799* (0.0506)
LMILE	-0.1104* (0.0322)	0.0812+ (0.0388)	0.1911* (0.0439)	0.2742* (0.0267)	-0.0071 (0.0320)	0.3622* (0.0661)	0.0600+ (0.0266)	0.1551* (0.0364)	0.0337 (0.0533)	0.0962* (0.0318)	0.4951* (0.0491)	0.1177* (0.0107)
LMILD	0.6290* (0.0315)	0.5131* (0.0366)	0.2064* (0.0431)	0.2547* (0.0248)	0.3716* (0.0268)	0.1659* (0.0638)	0.4099* (0.0245)	0.2813* (0.0277)	0.3681* (0.0475)	0.5099* (0.0315)	0.0202 (0.0460)	0.3671* (0.0088)
LENPL	-0.0564* (0.0084)	0.0151 (0.0102)	0.0412* (0.0139)	0.0319* (0.0092)	0.0284* (0.0069)	-0.0224 (0.0146)	0.0739* (0.0091)	0.0097 (0.0109)	0.0412+ (0.0190)	0.0551* (0.0066)	-0.0253 (0.0139)	0.0226* (0.0029)
LEQPS	0.1177* (0.0186)	-0.2238* (0.0645)	0.0129 (0.0328)	-0.0360 (0.0184)	-0.0535* (0.0190)	0.0008 (0.0378)	0.1960+ (0.0893)	-0.1109* (0.0380)	0.2061* (0.0283)	0.1193* (0.0132)	0.2964* (0.0334)	0.0628* (0.0072)
LLDFI	0.1878* (0.0514)	-0.2483* (0.0746)	-0.4135* (0.0912)	-0.2965* (0.0847)	0.4798* (0.0882)	-0.1960+ (0.0827)	-0.1216+ (0.0534)	-0.4858+ (0.2003)	-0.5274* (0.1052)	-0.4816* (0.0408)	0.3188* (0.0904)	-0.1683* (0.0209)
EPSH	0.9348* (0.0547)	0.4848* (0.0757)	-0.1330 (0.1471)	0.1428+ (0.0687)	-0.4311* (0.0863)	0.2334 (0.2176)	-0.3693* (0.0525)	-0.3028* (0.0666)	-0.0451 (0.1385)	0.5031* (0.0578)	0.2163+ (0.1033)	0.1708* (0.0226)
EPHD	0.1184* (0.0268)	0.0667 (0.0418)	0.1800* (0.0608)	0.1413* (0.0221)	0.0315 (0.0276)	-0.3728* (0.0817)	-0.0307 (0.0222)	0.0126 (0.0305)	0.1430+ (0.0631)	-0.0028 (0.0241)	0.1006 (0.0851)	0.0484* (0.0085)
RTSH	0.1995* (0.0334)	0.2415* (0.0396)	0.3525* (0.0902)	0.2114* (0.0466)	0.5121* (0.0409)	0.4596* (0.1028)	0.5967* (0.0363)	0.5520* (0.0450)	0.5493* (0.0594)	-0.0310 (0.0384)	0.3282* (0.0524)	0.3347* (0.0136)
RTHD	0.0377+ (0.0152)	0.0407+ (0.0163)	0.1470* (0.0247)	0.1128* (0.0143)	0.1267* (0.0171)	0.0986* (0.0347)	0.0319+ (0.0140)	0.0283 (0.0174)	-0.0133 (0.0328)	0.0692* (0.0149)	0.1114* (0.0277)	0.0684* (0.0054)
LTOUR	-0.0188* (0.0035)	-0.0847* (0.0076)	-0.0033 (0.0048)	-0.0302* (0.0046)	-0.0574* (0.0046)	-0.0270+ (0.0112)	-0.0005 (0.0053)	-0.0161* (0.0058)	0.0113 (0.0081)	-0.0064+ (0.0028)	-0.0076 (0.0054)	-0.0181* (0.0015)
LFREQ	0.0435* (0.0080)	-0.0474* (0.0084)	-0.0165 (0.0136)	0.0392* (0.0076)	0.0318* (0.0077)	0.0138 (0.0151)	-0.0500* (0.0082)	0.0691* (0.0105)	0.0037 (0.0122)	-0.0387* (0.0065)	0.1031* (0.0166)	0.0053 (0.0028)
CHPL	0.0282* (0.0070)	0.0338* (0.0087)	0.0708* (0.0087)	-0.0128+ (0.0064)	0.0701* (0.0073)	-0.0073 (0.0108)	0.0249* (0.0065)	0.0276* (0.0099)	0.0451* (0.0153)	-0.0083 (0.0054)	-0.0843* (0.0123)	0.0171* (0.0024)
STOP	0.0198* (0.0055)	0.0360* (0.0081)	0.0803* (0.0129)	0.0151+ (0.0064)	0.0626* (0.0061)	0.0005 (0.0090)	0.0085 (0.0066)	0.0269* (0.0100)	-0.0213 (0.0136)	0.0030 (0.0048)	0.0076 (0.0079)	0.0197* (0.0021)

ORDM 0.0773 (0.0025)*	ATLM 0.0654 (0.0025)*	DFWM -0.0003 (0.0031)	LAXM -0.0298 (0.0034)*	DENM -0.0558 (0.0038)*
EWRM -0.0384 (0.0039)*	SFOM 0.0200 (0.0028)*	LGAM -0.0055 (0.0035)	STLM 0.0184 (0.0045)*	BOSM 0.0197 (0.0033)*
JFKM -0.0073 (0.0047)	MIAM 0.0177 (0.0040)*	DTWM 0.0269 (0.0021)*	MSPM -0.0135 (0.0036)*	PITM 0.0440 (0.0034)*
DCAM 0.0244 (0.0031)*	IAHM -0.0297 (0.0040)*	PHLM 0.0425 (0.0030)*	LASM 0.0219 (0.0072)*	MCIM -0.0108 (0.0045)+
FLLM -0.0115 (0.0038)*	CLEM 0.0132 (0.0032)*	SNAM 0.0140 (0.0108)		

* = significant at 1% level + = significant at 5% level

TABLE 3

STRUCTURAL EQUATION DEPENDENT VARIABLE: LPR20 OBSERVATIONS: 73062 R-SQUARED: 0.6140

AIRLINE	AA	USAIR	CO	DL	EA	NW	PI	RC	TWA	UA	WA	AVERAGE
INTERCEPT	2.0568* (0.1707)	0.5524* (0.1746)	-0.2934 (0.1822)	-0.6160* (0.2118)	2.0866* (0.1736)	1.2140* (0.1965)	1.2300* (0.1497)	0.7902* (0.2719)	0.1921 (0.4032)	-0.1479 (0.1263)	1.6633* (0.2320)	0.7873* (0.0555)
LMILE	-0.1000* (0.0354)	0.0358 (0.0426)	0.6157* (0.0482)	0.3320* (0.0293)	0.0744+ (0.0351)	0.2387* (0.0725)	-0.0215 (0.0292)	0.2266* (0.0400)	0.1258+ (0.0586)	0.0889* (0.0349)	0.4313* (0.0539)	0.1501* (0.0118)
LMILD	0.5952* (0.0345)	0.5233* (0.0402)	-0.0437 (0.0473)	0.2347* (0.0272)	0.3290* (0.0294)	0.2925* (0.0701)	0.4808* (0.0269)	0.2705* (0.0304)	0.3438* (0.0521)	0.5122* (0.0345)	0.0901 (0.0505)	0.3582* (0.0107)
LENPL	-0.0642* (0.0093)	-0.0091 (0.0112)	0.0384+ (0.0152)	0.0752* (0.0101)	-0.0213* (0.0076)	-0.0212 (0.0 61)	0.0176 (0.0099)	0.0100 (0.0120)	0.0845* (0.0208)	0.0357* (0.0072)	-0.0407* (0.0153)	0.0060 (0.0032)
LEOPS	0.1263* (0.0204)	-0.0098 (0.0708)	-0.1125* (0.0360)	-0.0066 (0.0202)	-0.0306 (0.0209)	0.0269 (0.0414)	0.2548* (0.0880)	-0.1548* (0.0417)	0.1321* (0.0311)	0.1195* (0.0144)	0.3833* (0.0367)	0.0663* (0.0079)
LLDFI	0.3677* (0.0565)	-0.0178 (0.0819)	-0.6317* (0.1001)	-0.7680* (0.0930)	0.3982* (0.0968)	-0.0534 (0.0908)	-0.2036* (0.0586)	-0.8300* (0.2199)	-0.2870+ (0.1155)	-0.3653* (0.0448)	0.2711* (0.0892)	-0.1349* (0.0230)
EPSH	0.5969* (0.0601)	0.4600* (0.0831)	-0.6288* (0.1615)	-0.0372 (0.0754)	-0.2375+ (0.0947)	-0.0462 (0.2389)	-0.2320* (0.0577)	-0.2452* (0.0730)	-0.5660* (0.1520)	0.3356* (0.0635)	0.2598+ (0.1134)	0.0846* (0.0248)
EPHD	0.1644* (0.0294)	0.0452 (0.0459)	0.0148 (0.0668)	0.0521+ (0.0242)	0.0002 (0.0303)	-0.1689 (0.0897)	-0.0902* (0.0244)	-0.0360 (0.0335)	0.0862 (0.0693)	-0.0187 (0.0265)	0.0880 (0.0714)	0.0111 (0.0104)
RTSH	0.2428* (0.0366)	0.1707* (0.0437)	0.7053* (0.0990)	0.2652* (0.0512)	0.4595* (0.0448)	0.4363* (0.1129)	0.4364* (0.0398)	0.4395* (0.0494)	0.6268* (0.0652)	0.0371 (0.0421)	0.2728* (0.0575)	0.3160* (0.0150)
RTHD	0.0300 (0.0166)	0.0262 (0.0179)	0.1020* (0.0272)	0.1781* (0.0156)	0.1129* (0.0188)	0.0712 (0.0381)	0.0046 (0.0154)	0.0059 (0.0191)	0.0787+ (0.0361)	0.0898* (0.0163)	0.0905* (0.0304)	0.0665* (0.0059)
LTOUR	-0.0085+ (0.0038)	-0.0631* (0.0083)	0.0080 (0.0053)	0.0171* (0.0051)	-0.0334* (0.0050)	-0.0040 (0.0123)	0.0190* (0.0058)	0.0120 (0.0065)	0.0263* (0.0089)	0.0113* (0.0032)	0.0036 (0.0060)	0.0011 (0.0016)
LFREQ	0.0088 (0.0087)	-0.0342* (0.0103)	-0.0638* (0.0149)	0.0179+ (0.0084)	0.0254* (0.0085)	-0.0263 (0.0166)	-0.0251* (0.0090)	0.0554* (0.0115)	-0.0206 (0.0133)	-0.0463* (0.0072)	0.0612* (0.0182)	-0.0080+ (0.0031)
CHPL	0.0563* (0.0077)	0.0215+ (0.0096)	0.1023* (0.0096)	-0.0387* (0.0070)	0.0609* (0.0080)	0.0182 (0.0118)	0.0498* (0.0072)	-0.0096 (0.0109)	-0.0002 (0.0168)	0.0088 (0.0059)	-0.0823* (0.0135)	0.0221* (0.0026)
STOP	0.0238* (0.0060)	0.0236* (0.0089)	0.0666* (0.0141)	-0.0019 (0.0070)	0.0444* (0.0067)	-0.0044 (0.0099)	0.0198* (0.0073)	0.0329* (0.0109)	0.0038 (0.0149)	0.0022 (0.0053)	0.0104 (0.0087)	0.0172* (0.0024)

ORDM 0.0617 (0.0027)*
EWRM -0.0425 (0.0043)*
JFKM -0.0231 (0.0052)*
DCAM 0.0130 (0.0034)*
FLLM -0.0111 (0.0043)*

ATLM 0.0560 (0.0028)*
SFOM 0.0232 (0.0031)*
MIAM 0.0226 (0.0043)*
IAHM -0.0027 (0.0044)
CLEM 0.0173 (0.0035)*

DFWM 0.0078 (0.0034)+
LGAM -0.0028 (0.0039)
DTWM 0.0217 (0.0023)*
PHLM 0.0295 (0.0033)*
SNAM 0.0042 (0.0118)

LAXM -0.0259 (0.0037)*
STLM 0.0283 (0.0049)*
MSPM -0.0121 (0.0039)*
LASM 0.0124 (0.0079)

DENM -0.0682 (0.0043)*
BOSM 0.0232 (0.0036)*
PITM 0.0329 (0.0037)*
MCIM -0.0112 (0.0049)+

* = significant at 1% level + = significant at 5% level

TABLE 4

STRUCTURAL EQUATION DEPENDENT VARIABLE: LPRBO OBSERVATIONS: 73062 R-SQUARED: 0.5345

AIRLINE	AA	USAIR	CO	DL	EA	NW	PI	RC	TWA	UA	WA	AVERAGE
INTERCEPT	1.7719*	-0.7769*	0.0025	0.5799+	1.7160*	1.1785*	0.4161+	1.7022*	2.1917*	-0.2750	1.8020*	0.6389*
	(0.1985)	(0.2030)	(0.2119)	(0.2462)	(0.2019)	(0.2285)	(0.1740)	(0.3162)	(0.4688)	(0.1469)	(0.2698)	(0.0646)
LMILE	-0.0794	0.1539*	0.5259*	0.2966*	-0.0456	0.4857*	0.1322*	0.1870*	0.0262	0.1822*	0.5849*	0.1787*
	(0.0412)	(0.0486)	(0.0561)	(0.0340)	(0.0408)	(0.0843)	(0.0340)	(0.0485)	(0.0681)	(0.0406)	(0.0627)	(0.0137)
LMILD	0.6160*	0.4793*	-0.0518	0.2467*	0.3989*	0.0650	0.3503*	0.2403*	0.3307*	0.4116*	-0.0665	0.3206*
	(0.0402)	(0.0467)	(0.0550)	(0.0316)	(0.0342)	(0.0815)	(0.0313)	(0.0353)	(0.0606)	(0.0402)	(0.0587)	(0.0125)
LENPL	-0.0495*	0.0472*	0.1121*	0.0310*	0.0647*	-0.0277	0.0994*	0.0115	0.0079	0.0659*	-0.0213	0.0396*
	(0.0108)	(0.0130)	(0.0177)	(0.0117)	(0.0088)	(0.0187)	(0.0116)	(0.0139)	(0.0242)	(0.0084)	(0.0178)	(0.0037)
LEOPS	0.0789*	-0.4080*	-0.0191	-0.0809*	-0.0730*	-0.0792	0.1050	-0.1234+	0.2529*	0.0790*	0.2320*	0.0273*
	(0.0237)	(0.0823)	(0.0418)	(0.0235)	(0.0243)	(0.0482)	(0.1140)	(0.0485)	(0.0361)	(0.0168)	(0.0427)	(0.0092)
LLDFI	0.1233	-0.4738*	-0.1191	-0.1370	0.5353*	-0.3027*	-0.0740	-0.2061	-0.5832*	-0.5010*	0.4792*	-0.1635*
	(0.0656)	(0.0853)	(0.1164)	(0.1081)	(0.1125)	(0.1056)	(0.0662)	(0.2556)	(0.1343)	(0.0521)	(0.1154)	(0.0267)
EPSH	1.1070*	0.5473*	-0.9770*	0.1572	-0.6719*	0.1748	-0.4567*	-0.4525*	0.0517	0.5169*	-0.0004	0.1310*
	(0.0699)	(0.0966)	(0.1878)	(0.0877)	(0.1101)	(0.2777)	(0.0670)	(0.0849)	(0.1767)	(0.0738)	(0.1319)	(0.0289)
EPHD	0.1010*	0.0473	0.1990+	0.1887*	0.0602	-0.4475*	-0.0039	0.0281	0.2270*	0.0035	0.1022	0.0861*
	(0.0341)	(0.0534)	(0.0777)	(0.0282)	(0.0352)	(0.1043)	(0.0283)	(0.0390)	(0.0806)	(0.0308)	(0.0830)	(0.0121)
RTSH	0.2323*	0.2585*	0.9058*	0.2306*	0.5941*	0.5850*	0.6987*	0.6793*	0.5870*	0.0126	0.4230*	0.4078*
	(0.0426)	(0.0506)	(0.1151)	(0.0585)	(0.0521)	(0.1313)	(0.0463)	(0.0574)	(0.0789)	(0.0490)	(0.0669)	(0.0174)
RTHO	0.0319	0.0643*	0.1389*	0.0843*	0.1463*	0.1107+	0.0430+	0.0577*	-0.0582	0.0533*	0.1540*	0.0723*
	(0.0193)	(0.0208)	(0.0316)	(0.0182)	(0.0219)	(0.0443)	(0.0179)	(0.0222)	(0.0420)	(0.0180)	(0.0354)	(0.0069)
LTOUR	-0.0291*	-0.1064*	-0.0101	-0.0636*	-0.0892*	-0.0409*	-0.0176*	-0.0370*	-0.0094	-0.0187*	-0.0129	-0.0331*
	(0.0045)	(0.0097)	(0.0061)	(0.0059)	(0.0059)	(0.0143)	(0.0068)	(0.0075)	(0.0103)	(0.0038)	(0.0070)	(0.0019)
LFREQ	0.0416*	-0.0740*	-0.1116*	0.0405*	0.0336*	0.0286	-0.0626*	0.0683*	0.0041	-0.0419*	0.1252*	-0.0017
	(0.0102)	(0.0120)	(0.0173)	(0.0087)	(0.0099)	(0.0193)	(0.0105)	(0.0133)	(0.0155)	(0.0063)	(0.0212)	(0.0036)
CHPL	0.0237*	0.0424*	0.1228*	-0.0036	0.0811*	-0.0150	0.0198+	0.0506*	0.0824+	-0.0056	-0.1110*	0.0245*
	(0.0080)	(0.0111)	(0.0112)	(0.0081)	(0.0083)	(0.0137)	(0.0083)	(0.0127)	(0.0195)	(0.0069)	(0.0187)	(0.0030)
STOP	0.0201*	0.0418*	0.0855*	0.0348*	0.0735*	0.0044	0.0109	0.0283+	-0.0231	0.0071	0.0140	0.0265*
	(0.0070)	(0.0103)	(0.0165)	(0.0081)	(0.0077)	(0.0115)	(0.0084)	(0.0127)	(0.0174)	(0.0061)	(0.0101)	(0.0027)

ORDM	0.0894 (0.0032)*	ATLM	0.0716 (0.0032)*	DFWM	-0.0028 (0.0039)	LAXN	-0.0410 (0.0043)*	DENM	-0.0810 (0.0080)*
EWRM	-0.0342 (0.0050)*	SFOM	0.0156 (0.0036)*	LGAM	-0.0044 (0.0045)	SILM	0.0115 (0.0057)+	BOSM	0.0183 (0.0042)*
JFKM	-0.0062 (0.0060)	MIAM	0.0151 (0.0050)*	DTWM	0.0323 (0.0027)*	MSPM	-0.0124 (0.0046)*	PITM	0.0487 (0.0043)*
DCAM	0.0362 (0.0040)*	IAHM	-0.0361 (0.0052)*	PHLM	0.0527 (0.0039)*	LASM	0.0284 (0.0091)*	MCIM	-0.0119 (0.0058)+
FLLM	-0.0147 (0.0050)*	CLEM	0.0141 (0.0041)*	SNAM	0.0201 (0.0138)				

* = significant at 1% level   + = significant at 5% level

TABLE 5

REDUCED-FORM EQUATION DEPENDENT VARIABLE: LPRAV OBSERVATIONS: 73062 R-SQUARED: 0.6434

AIRLINE	AA	USAIR	CO	DL	EA	NW	PI	RC	TWA	UA	WA	AVERAGE
INTERCEPT	1.8864* (0.1631)	0.4034+ (0.1838)	1.7677* (0.1756)	0.9930* (0.1498)	2.3595* (0.1374)	1.8158* (0.2035)	2.1322* (0.1370)	2.5751* (0.2800)	2.7435* (0.4059)	-0.1820 (0.1209)	2.5307* (0.2497)	1.4409* (0.0514)
LMILE	-0.1677* (0.0290)	0.0039 (0.0357)	0.1391* (0.0390)	0.2498* (0.0239)	-0.0142 (0.0307)	0.2931* (0.0647)	0.0354 (0.0268)	-0.0212 (0.0335)	-0.0925 (0.0510)	0.1190* (0.0283)	0.3613* (0.0472)	0.0689* (0.0100)
LMILD	0.7015* (0.0269)	0.6003* (0.0343)	0.2691* (0.0365)	0.2865* (0.0218)	0.4216* (0.0260)	0.2571* (0.0618)	0.4732* (0.0244)	0.4364* (0.0250)	0.5249* (0.0443)	0.4881* (0.0267)	0.1851* (0.0449)	0.4406* (0.0089)
LENPL	-0.0368* (0.0082)	0.0110 (0.0105)	0.0242 (0.0127)	0.0349* (0.0079)	0.0195* (0.0069)	-0.0352* (0.0134)	0.0347* (0.0084)	0.0050 (0.0110)	0.0102 (0.0189)	0.0579* (0.0065)	-0.0335+ (0.0139)	0.0176* (0.0028)
LEQPS	0.1089* (0.0181)	-0.2546* (0.0630)	0.0011 (0.0328)	-0.0137 (0.0183)	-0.0478* (0.0182)	0.0073 (0.0377)	0.2578* (0.0889)	-0.0548 (0.0388)	0.2439* (0.0290)	0.1194* (0.0131)	0.3460* (0.0330)	0.0705* (0.0071)
LLDFF	0.1339* (0.0480)	-0.2642* (0.0730)	-0.4285* (0.0898)	-0.2735* (0.0688)	0.3305* (0.0709)	-0.1959+ (0.0821)	-0.1435* (0.0508)	-0.4607+ (0.2068)	-0.5130* (0.1032)	-0.4748* (0.0382)	0.3501* (0.0924)	-0.1779* (0.0196)
EPSH	1.0480* (0.0417)	0.7488* (0.0395)	0.3916* (0.0483)	0.3427* (0.0336)	0.2652* (0.0444)	0.8064* (0.1178)	0.1664* (0.0254)	0.2933* (0.0349)	0.7918* (0.0919)	0.4069* (0.0334)	0.5795* (0.0675)	0.4215* (0.0122)
EPHD	0.1782* (0.0270)	0.1493* (0.0433)	0.3105* (0.0626)	0.1897* (0.0224)	0.1281* (0.0287)	-0.2544* (0.0863)	0.0393 (0.0220)	0.1867* (0.0306)	0.3419* (0.0678)	-0.0082 (0.0243)	0.1548+ (0.0748)	0.1185* (0.0096)
LCPSH	0.0079* (0.0008)	0.0059* (0.0011)	0.0051* (0.0014)	0.0049* (0.0008)	0.0069* (0.0009)	0.0071* (0.0020)	0.0108* (0.0010)	0.0086* (0.0011)	0.0031+ (0.0015)	0.0019+ (0.0008)	-0.0044* (0.0016)	0.0058* (0.0003)
LEPAV	-0.0154* (0.0046)	-0.0364* (0.0057)	-0.0201+ (0.0084)	-0.0248* (0.0044)	-0.0181* (0.0054)	-0.0137 (0.0096)	-0.0417* (0.0050)	-0.0682* (0.0059)	-0.0649* (0.0100)	0.0029 (0.0040)	-0.0403* (0.0087)	-0.0257* (0.0017)
LEPMN	-0.0071 (0.0040)	-0.0042 (0.0048)	-0.0015 (0.0066)	-0.0094+ (0.0042)	-0.0313* (0.0042)	-0.0246* (0.0072)	-0.0440* (0.0035)	0.0027 (0.0043)	-0.0230* (0.0074)	-0.0100* (0.0035)	-0.0268* (0.0071)	-0.0167* (0.0014)
RTHD	0.0605* (0.0146)	0.0421+ (0.0164)	0.1517* (0.0255)	0.0967* (0.0143)	0.0965* (0.0176)	0.1385* (0.0319)	0.0297+ (0.0140)	0.0522* (0.0177)	-0.0346 (0.0331)	0.0544* (0.0128)	0.0822* (0.0279)	0.0651* (0.0053)
LTOUR	-0.0165* (0.0034)	-0.1087* (0.0076)	-0.0036 (0.0048)	-0.0277* (0.0045)	-0.0584* (0.0045)	-0.0246+ (0.0111)	-0.0097 (0.0053)	-0.0353* (0.0059)	0.0029 (0.0081)	-0.0064+ (0.0029)	-0.0083 (0.0054)	-0.0212* (0.0014)
LFREQ	0.0392* (0.0083)	-0.0314* (0.0102)	0.0053 (0.0124)	0.0482* (0.0075)	0.0491* (0.0081)	0.0458* (0.0137)	0.0049 (0.0084)	0.0710* (0.0110)	0.0509* (0.0130)	-0.0373* (0.0068)	0.1296* (0.0178)	0.0221* (0.0029)
CHPL	0.0308* (0.0077)	0.0279* (0.0093)	0.0671* (0.0109)	-0.0173+ (0.0080)	0.0550* (0.0084)	-0.0145 (0.0129)	-0.0102 (0.0076)	0.0540* (0.0109)	0.0227 (0.0161)	-0.0104 (0.0063)	-0.1224* (0.0133)	0.0084* (0.0027)
STOP	0.0174* (0.0056)	0.0275* (0.0081)	0.0479* (0.0132)	0.0110 (0.0065)	0.0477* (0.0064)	-0.0041 (0.0093)	-0.0308* (0.0066)	0.0252+ (0.0100)	-0.0221 (0.0138)	-0.0017 (0.0048)	-0.0022 (0.0080)	0.0083* (0.0022)

ORDM	0.0749	(0.0025)*	ATLM	0.0822	(0.0025)*	DFWM	-0.0045	(0.0030)	LAXM	-0.0274	(0.0034)*	DENM	-0.0589	(0.0039)*
EWRM	-0.0298	(0.0040)*	SFOM	0.0216	(0.0028)*	LGAM	0.0085	(0.0035)+	STLM	0.0197	(0.0045)*	BOSM	0.0222	(0.0033)*
JFKM	0.0156	(0.0047)*	MIAM	0.0117	(0.0037)*	DTWM	0.0249	(0.0021)*	MSPM	-0.0183	(0.0036)*	PITM	0.0451	(0.0033)*
DCAM	0.0286	(0.0031)*	IAHM	-0.0315	(0.0040)*	PHLM	0.0416	(0.0030)*	LASM	0.0228	(0.0071)*	MCIM	-0.0110	(0.0044)+
FLLM	-0.0062	(0.0038)	CLEM	0.0170	(0.0032)*	SNAM	0.0278	(0.0105)*						

* = significant at 1% level + = significant at 5% level

TABLE 6

AVG. PARAMETER ESTIMATES OF REDUCED-FORM EQUATIONS WITH ALTERNATIVE DEPENDENT VARS.

DATASET: Obs w/ > 2 passengers (unweighted)		
R-SQUARED:	0.6201	0.5459
OBSERVATIONS:	73062	73062
DEPENDENT VAR:	LPR20	LPR80
INTERCEPT	1.4044* (0.0565)	1.3777* (0.0654)
LMILE	0.0984* (0.0109)	0.1147* (0.0127)
LMILD	0.4378* (0.0098)	0.4134* (0.0114)
LENPL	0.0000 (0.0031)	0.0322* (0.0036)
LEQPS	0.0761* (0.0078)	0.0380* (0.0091)
LLDFF	0.1438* (0.0215)	0.1705* (0.0249)
EPSH	0.3239* (0.0134)	0.4508* (0.0155)
EPHD	0.0828* (0.0106)	0.1535* (0.0123)
LCPSH	0.0040* (0.0003)	0.0068* (0.0004)
LEPAV	0.0264* (0.0019)	0.0320* (0.0022)
LEPMN	0.0199* (0.0015)	0.0200* (0.0018)
RTHD	0.0570* (0.0058)	0.0695* (0.0067)
LTOUR	0.0004 (0.0016)	0.0358* (0.0018)
LFREQ	0.0160* (0.0031)	0.0187* (0.0036)
CHPL	0.0073+ (0.0030)	0.0124* (0.0035)
STOP	0.0079+ (0.0024)	0.0141* (0.0028)

* = significant at 1% level   + = significant at 5% level

AVG. PARAMETER ESTIMATES OF STRUCTURAL EQUATIONS WITH ALTERNATIVE DATASETS

DATASET:	All Obs. (weighted)	All Obs. (unweighted)
R-SQUARED:	0.6518	0.4870
OBSERVATIONS:	151308	151308
DEPENDENT VAR:	LPRAV	LPRAV
INTERCEPT	1.0830* (0.0135)	1.2797* (0.0455)
LMILE	0.2320* (0.0032)	0.2555* (0.0084)
LMILD	0.2732* (0.0030)	0.2170* (0.0075)
LENPL	0.0182* (0.0008)	0.0042 (0.0026)
LEQPS	0.0309* (0.0016)	0.1316* (0.0066)
LLDFI	0.0154+ (0.0063)	0.1571* (0.0194)
EPSH	0.0189* (0.0053)	0.4477* (0.0215)
EPHD	0.1114* (0.0026)	0.0667* (0.0085)
RTSH	0.6120* (0.0032)	0.1452* (0.0138)
RTHD	0.0161* (0.0013)	0.0580* (0.0048)
LTOUR	0.0375* (0.0004)	0.0186* (0.0013)
LFREQ	0.0235* (0.0007)	0.0150* (0.0025)
CHPL	0.0014+ (0.0005)	0.0261* (0.0017)
STOP	0.0078* (0.0006)	0.0066* (0.0017)

AVG. PARAM. ESTIMATES OF REDUCED-FORM EQUATIONS WITH ALTERNATIVE DATASETS

DATASET:	All Obs. (weighted)	All Obs. (unweighted)
R-SQUARED:	0.6959	0.4967
OBSERVATIONS:	151308	151308
DEPENDENT VAR:	LPRAV	LPRAV
INTERCEPT	1.8681* (0.0141)	1.2639* (0.0471)
LMILE	0.1177* (0.0020)	0.2643* (0.0075)
LMILD	0.4083* (0.0027)	0.2116* (0.0065)
LENPL	0.0009 (0.0008)	0.0159* (0.0026)
LEQPS	0.0121* (0.0015)	0.1168* (0.0064)
LLDFF	0.0274* (0.0059)	0.2082* (0.0185)
EPSH	0.8444* (0.0032)	0.5147* (0.0103)
EPHD	0.1807* (0.0028)	0.0818* (0.0086)
LCPSH	0.0074* (0.0001)	0.0077* (0.0003)
LEPAV	0.0389* (0.0006)	0.0010 (0.0014)
LEPMN	0.0404* (0.0003)	0.0006 (0.0012)
RTHD	0.0029+ (0.0013)	0.0714* (0.0047)
LTOUR	0.0436* (0.0004)	0.0178* (0.0013)
LFREQ	0.0341* (0.0006)	0.0089* (0.0025)
CHPL	0.0280* (0.0006)	0.0339* (0.0018)
STOP	0.0078* (0.0006)	0.0020 (0.0017)

TABLE 7

AVG. PARAMETER ESTIMATES OF STRUCTURAL EQUATIONS
WITH ALTERNATIVE SPECIFICATION OF SHARE VARIABLES

DATASET: Observations w/ > 2 passengers (unweighted)

R-SQUARED:	0.6431	0.6144	0.5420
OBSERVATIONS:	73062	73062	73062
DEPENDENT VAR:	LPRAV	LPR20	LPR80
INTERCEPT	1.3878*	1.1960*	1.1991*
	(0.0511)	(0.0565)	(0.0652)
LMILE	0.1309*	0.1585*	0.1803*
	(0.0112)	(0.0123)	(0.0142)
LMILD	0.3600*	0.3404*	0.3141*
	(0.0103)	(0.0114)	(0.0132)
LEMPL	0.0181*	0.0048	0.0358*
	(0.0029)	(0.0032)	(0.0037)
LEOPS	0.0621*	0.0699*	0.0248*
	(0.0072)	(0.0079)	(0.0092)
LLDFI	0.1600*	0.1168*	0.1684*
	(0.0208)	(0.0230)	(0.0266)
LEPSH	0.0501*	0.0172*	0.0516*
	(0.0041)	(0.0045)	(0.0052)
LEPHD	0.0486*	0.0315*	0.0551*
	(0.0026)	(0.0029)	(0.0033)
LRTSH	0.0684*	0.0742*	0.0802*
	(0.0034)	(0.0037)	(0.0043)
LRTHD	0.0073*	0.0036*	0.0099*
	(0.0009)	(0.0010)	(0.0012)
LTOUR	0.0200*	0.0005	0.0336*
	(0.0014)	(0.0016)	(0.0018)
LFREQ	0.0029	0.0098*	0.0042
	(0.0026)	(0.0030)	(0.0035)
CHPL	0.0180*	0.0242*	0.0262*
	(0.0023)	(0.0025)	(0.0029)
STOP	0.0171*	0.0159*	0.0238*
	(0.0021)	(0.0023)	(0.0027)

AVG. PARAMETER ESTIMATES OF REDUCED-FORM EQUATIONS
WITH ALTERNATIVE SPECIFICATION OF SHARE VARIABLES

DATASET: Observations w/ > 2 passengers (unweighted)

R-SQUARED:	0.6453	0.6192	0.5492
OBSERVATIONS:	73062	73062	73062
DEPENDENT VAR:	LPRAV	LPR20	LPR80
INTERCEPT	1.8640*	1.7915*	1.8147*
	(0.0512)	(0.0564)	(0.0650)
LMILE	0.0581*	0.0885*	0.1048*
	(0.0100)	(0.0110)	(0.0126)
LMILD	0.4479*	0.4436*	0.4206*
	(0.0089)	(0.0098)	(0.0113)
LEMPL	0.0112*	0.0048	0.0257*
	(0.0028)	(0.0031)	(0.0036)
LEOPS	0.0694*	0.0773*	0.0364*
	(0.0071)	(0.0079)	(0.0091)
LLDFF	0.1613*	0.1202*	0.1606*
	(0.0197)	(0.0217)	(0.0250)
LEPSH	0.0948*	0.0643*	0.1055*
	(0.0022)	(0.0024)	(0.0028)
LEPHD	0.0579*	0.0446*	0.0701*
	(0.0027)	(0.0029)	(0.0034)
LCPSH	0.0048*	0.0035*	0.0053*
	(0.0003)	(0.0003)	(0.0004)
LEPAV	0.0244*	0.0272*	0.0299*
	(0.0017)	(0.0019)	(0.0022)
LEPMN	0.0108*	0.0179*	0.0123*
	(0.0014)	(0.0016)	(0.0018)
RTHD	0.0084*	0.0041*	0.0112*
	(0.0008)	(0.0010)	(0.0012)
LTOUR	0.0216*	0.0010	0.0360*
	(0.0014)	(0.0016)	(0.0018)
LFREQ	0.0180*	0.0149*	0.0132*
	(0.0029)	(0.0032)	(0.0036)
CHPL	0.0111*	0.0067+	0.0149*
	(0.0027)	(0.0030)	(0.0035)
STOP	0.0077*	0.0060+	0.0128*
	(0.0022)	(0.0024)	(0.0028)

* = significant at 1% level   + = significant at 5% level

Table 8: Definitions of Variables In Pricing Equations

PRAV – Average price for all passengers traveling a given itinerary.

PR20, PR80 – Twentieth and eightieth percentile fares paid by passengers traveling a given itinerary.

MILE – Total mileage flown on the itinerary.

MILD – Total nonstop mileage from origin to destination points on the itinerary, ignores plane changes or on-flight stops.

EQP5 – Average number of seats on planes carrying passengers on the itinerary. Set equal to 1 ($\log(EQP5) = 0$) if average length of haul for the itinerary is less than 500 miles.

ENPL – The airline's average number of enplanements at all airports involved in the itinerary.

LDFI – Average load factor on all portions of itinerary. Two-stage least-squares estimation as described in the text.

LDFF – Fitted value for average load factor on all portions of itinerary. Instrumental variables construction of fitted values as described in the appendix.

STOP – Average number of on-flight stops by passengers on the itinerary.

CHPL – Number of plane changes on the itinerary.

TRIX – Tourism index for a metropolitan area = Hotel Income from Group/Tourist customers divided by Total Personal Income. See Borenstein (1983).

TOUR – Average tourism index of all origin and destination cities on the itinerary weighted inversely to the proportion of passengers on each directional segment that begin their trips at each endpoint.

FREQ – Average number of daily departures on each segment of the itinerary.

RTSH – Average, over all directional segments in the itinerary, of the carrier's share of traffic carried on each directional segment. Two-stage least-squares estimation as described in the text.

RTHO – Average Herfindahl index of the shares of the traffic carried on the each directional segment by all carrier's other than the one observed.

EPSH – The airline's average share of enplanements at all airports that are origin or destination points on the itinerary, EPHO - Average Herfindahl index of the shares of enplanements by all carrier's other than the one observed at all airports that are origin or destination points on the itinerary.

CPSH - The airline's average share of non-stop and direct service on the direction segments (omits change-of-plane points) of the itinerary, as measured by available seats.

EPAV - The average number of enplanements by all carrier's other than the one observed at all airports that are origin or destination points on the itinerary.

EPMN - The minimum number of enplanements by all carrier's other than the one observed among all airports that are origin or destination points on the itinerary.

— — — M - Number of operations, takeoffs plus landings, on the itinerary occurring at the airport whose three letter code is the same as the first three letters of the variable name, divided by the MILD of the itinerary (in thousands of miles).

* In the regression result tables, an 'L' before the name of a variable indicates natural log.

Appendix: Data Description and Construction of Variables

Each observation in the sample is a unique airline/itinerary combination. An itinerary is specified by the airport of origin and every downline airport at which the passenger changed planes or terminated a portion of the trip (a directional break points). Databank 1A (DB1A) of the Department of Transportation's Origin and Destination Survey contains these airline and itinerary data, along the price paid, for a random 10% sample of all tickets that originate in the U.S on domestic carriers.[65] For this study, all fares paid for the same airline/itinerary were aggregated into a single observation, preserving the average fare paid the standard deviation of fares paid, and the 20th and 80th percentile fare paid.

The following observations were eliminated from the sample:

a. Tickets that included at least one segment designated as first-class travel.

b. Tickets that included travel on more than one airline (known as interline tickets).

c. Tickets for travel on any airline other the the 11 largest that are reported in the regression results tables.

d. Tickets that included more than 6 segments.

e. Tickets that include an origin, directional breakpoint or change of plane at an airport outside of the U.S. or an airport within the U.S. that is not one of the 200 largest U.S. airports.[66]

f. Tickets indicating flights of which there is no record in the Service Segment Data, as described below. (These amounted to fewer than 1% of passengers. See footnote 68.)

g. Tickets indicating fares of less than $10. (These are presumed to be keypunch errors or reporting of frequent flyer bonus trips, which is unfortunately not done in any consistent way.)

As discussed in the text, the Service Segment Data (ER-586) are a census of every flight operated by the largest pre-deregulation airlines. Because these are simply counts of the number of people on board each flight, these data are considered a more accurate reflection of total numbers of passengers than the DB1A sample. In fact, inconsistencies between the two data sets indicate that airlines do not always report 10% of their passengers. Boeing Computer Services, which works with these data extensively, calculates for each quarter a reporting rate for each airline, which is available to their customers in a quarterly newsletter. These reporting rates were used to adjust the number of passengers reported by each carrier in the DB1A in order to get a more accurate measure of market shares.

Each airline's number of enplanements at each airport is drawn from the Nonstop Market Data (T-9), a service segment data set that includes all airlines, as processed and reported by I.P. Sharp Company.

Construction and Source for each variable:

PRAV, PR20, PR80 – The average, twentieth and eightieth percentile fares paid by passengers traveling a given airline/itinerary. Source: DB1A

MILE – Total mileage flown between airports shown on the DB1A as part of the itinerary (excludes additional mileage due to on-plane stops). Source: Distances between airports from DB1A and Service Segment Data. Airports in a given itinerary from DB1A.

---

[65] Databank 1A (O&D DB1A), the Service Segment Data (ER-586), and Nonstop Market Data (T-9) are available from the Transportation Systems Center in Cambridge, MA.

[66] This excludes very few domestic flights, as the 200th largest airport is in Deadhorse, Alaska, where an average of 138 passengers were enplaned each day.

MILD - Total nonstop mileage from each directional origin to the following directional destination on the itinerary (ignores change-of-plane or on-flight stops). Source: DB1A.

EQP5 - Average number of seats on planes carrying passengers on the itinerary. Set equal to 1 ($\log(EQP5) = 0$) if average length of haul $(MILE/(CHPL + STOP))$ for the itinerary is less than 500 miles. If average haul is greater than 500, the airline's average number of seats on flights on each segment of the itinerary is calculated. EQP5 is then a weighted average of the average number of seats on each segment, where the weights are distances of each segment (excludes on-flight stops as segment breaks and in calculation of distance of each segment). For each airline the (log) variable has been rescaled so that its mean is zero for observations of greater than 500 mile haul lengths. This is to assure that the variable does not also act as an indicator variable for longer trips, independent of equipment size. Absent this adjustment, nearly all parameter estimates are negative, indicating the current specifications tend to predict prices on longer flights that are too high. Source: Service Segment Data.

ENPL - The airline's average number of enplanements at all airports shown in the DB1A itinerary (excludes on-flight stops). Source: I.P. Sharp processing of Nonstop Market Data (T-9).

LDFI - Average load factor on all segments of itinerary. An airline's average load factor on a segment is calculated as the carrier's total Revenue Passenger-Miles on planes flying from the first airport to the second, divided by the carrier's total Available Seat-Miles between those two airports during the quarter. LDFI is then a weighted average of the average load factors on each segment of the itinerary where the weights are the nonstop distance between the cities of each segment (excludes additional circuity from on-flight stops in calculation of distance).[67] Source: Service Segment Data.

LDFF - Instrument for average load factor on all segments of itinerary. Identifying the effect of load factor requires a variable that is correlated with the actual load factors of the flights on which the passengers in an observation travelled, but is not causally influenced by the price charged to those passengers. Essentially, the identifying variable used was the load factor attributable to people who were flying on the same plane as those on a given airline/itinerary, but who were on different itineraries that were not affected by the price in the observation. To do this, two fitted load factor variables were calculated for each flight segment of each carrier in the service segment data. LOADFIT1 came from a regression of the load factor on flights between two airports on (a) the proportion of seats filled by people who were on the same plane, but were not flying between those two airports (either enplaning at some other city or deplaning elsewhere) and (b) the proportion of seats filled by people who were local passengers between those two cities, *i.e.*, the first airport of the segment were these passengers' point of enplanement and the second airport was their point of deplanement and was a directional breakpoint for them, not just a change-of-plane stop. These fitted values were used for calculation of average load factor on an itinerary when a passenger on a given flight was connecting, *i.e.*, changing planes at the deplanement point. Conversely, LOADFIT2 was calculated from a regression of load factor on (a) the proportion of seats filled by people not enplaning and deplaning at the cities in question (same as in the first regression), and (b) those flying between the two cities, but connecting with other flights. These fitted values were used as an instrument for load factor when a passenger on a given flight was local. The fitted load factors were then included as excluded exogenous variables in the first stage of the 2SLS estimation. **Source:** Service Segment Data.

---

[67] See footnote 68 for exclusion of certain routes due to lack of flight data.

STOP – Average number of on-flight stops by passengers on the itinerary. For each airport pair that the airline serves on a direct basis (no change of planes), the service segment data allow calculation of the average number of on-flight stops made by passengers who flew between those two airports on the airline. For a given itinerary, STOP is the sum of the average number of stops that passengers of the airline made in flying on each of the segments of the itinerary.[68] **Source:** Service Segment Data.

CHPL – Number of plane changes on the itinerary. The number of segments of the itinerary that do not end in directional breakpoints ("directional breakpoints" includes the terminating airport of the itinerary). **Source:** DB1A.

TRIX – Tourism index for a metropolitan area = Hotel Income from Group/Tourist customers divided by Total Personal Income. **Source:** See Borenstein (1983).

TOUR – Average tourism index of all origin and destination cities on the itinerary weighted inversely to the proportion of passengers on each directional segment that begin their trips at each endpoint. **Source:** TRIX and DB1A

FREQ – Number of daily direct flights by the carrier averaged over the segments of the itinerary. **Source:** Service Segment Data.

RTSH – Average, over all directional segments in the itinerary, of the carrier's share of traffic carried on each directional segment (excludes change-of-plane points). Total reported passengers transported between two airports – where one of the airports is the passenger's directional origin and the other is the directional destination – is adjusted by the airline's reporting rate (from Boeing). The adjusted quantities for each airport pair are summed across all airlines to create the airport-pair total from which shares are calculated. **Source:** DB1A and Boeing Computer Services.

RTHO – Average Herfindahl index of the shares of the traffic carried on the each directional segment by all carrier's other than the one observed. The total quantity from which shares are calculated is the quantity from all airlines other than the one in the observation (quantities adjusted by Boeing reporting rates). The shares of each other airline is calculated from which the RTHO is constructed. **Source:** DB1A and Boeing Computer Services.

EPSH – The airline's average share of enplanements at all airports that are directional origins or directional destination points on the itinerary. **Source:** Nonstop Market Data (T-9) as processed and reported by I.P. Sharp Company.

EPHO – Average Herfindahl index of the shares of enplanements by all carrier's other than the one observed at all airports that are origin or destination points on the itinerary. Constructed as RTHO, but using endpoint enplanement shares. **Source:** Nonstop Market Data (T-9) as processed and reported by I.P. Sharp Company.

CPSH – The airline's average share of direct service on the directional segments (omits change-of-plane points) of the itinerary, as measured by share of available seats. For each directional segment the carrier's share of available seats was calculated. A weighted average across directional segments was then calculated with the weights being the

---

[68] Some segments of the DB1A do not actually correspond to single-plane service, because carriers occasionally change aircraft, but retain the same flight number on a routing. Thus, there could be segments in the DB1A for which there is no record of single-plane service in the Service Segment Data. These itineraries were eliminated from the data set as explain in exclusion f.

nonstop mileage of each directional segment. Source: Service Segment Data.

EPAV - The average number of enplanements by all carrier's other than the one observed at all airports that are directional origins or destinations on the itinerary. Source: Nonstop Market Data (T-9) as processed and reported by I.P. Sharp Company.

EPMN - The minimum number of enplanements by all carrier's other than the one observed among all airports that are directional origins or destinations on the itinerary. Source: Nonstop Market Data (T-9) as processed and reported by I.P. Sharp Company.

_ _ _ M - Number of operations, takeoffs plus landings, on the itinerary occurring at the airport whose three letter code is the same as the first three letters of the variable name, divided by the MILD of the itinerary (MILD rescaled to thousands of miles). Source: DB1A and U.S. Federal Aviation Administration (1987).

Definitions of Terms

Illustration for use in definitions: A record in the DB1A shows the number of people who flew SFO-STL-JFK(X)-MSP-SEA(X) and paid $503 for the ticket.[60] These people began their trip in San Francisco, flew to St. Louis where they changed planes and continued on to Kennedy airport in New York. New York was a destination point in their trip, as indicated by the (X). At a later time, these passengers flew from Kennedy to Minneapolis/St. Paul where they changed planes and took the last leg of their trip to Seattle, also a destination point, as well as the termination of their trip. The trip may have involved on-flight stops, but these do not show up in the DB1A.

Change-of-Plane Airport - Any airport in the itinerary that is not a Directional Origin or Directional Destination, STL and MSP in the illustration.

Directional Breakpoint or *Directional Destination* - Any airport that is a destination point in the itinerary, rather than simply a change-of-plane airport. In the illustration, JFK and SEA are directional breakpoints.

Directional Segment - Travel from a Directional Origin to a Directional Breakpoint (also called a Directional Destination). In the illustration, SFO-JFK and JFK-SEA are Directional Segments.

Directional Origin - The Ticket Origin or any Directional Breakpoint except the Ticket Termination. In the illustration, SFO and JFK are Directional Origins.

Downline Airport (also know as Downline Point) - Used in reference to the DB1A, any airport that is the termination of a segment. In the illustration, STL, JFK, MSP, and SEA are Downline Airports. Used in reference to the Service Segment Data, any airport at which a flight observed at a given airport later stops.

Direct Service - A flight that allows a person to travel from one airport to another without changing planes. In the illustration, there is direct service on each of the segments.

Segment (also known as Coupon, because a different coupon from one's ticket is necessary to board each flight) - Travel on a single flight. In the illustration, the trip had 4 segments (SFO-STL, STL-JFK, JFK-MSP, MSP-SEA)

Ticket Origin - The first airport shown on a ticket, SFO in the illustration.

Ticket Termination - The last airport shown on a ticket, SEA in the illustration.

---

[60] As explained earlier all trips with the same itinerary, but different fares, were aggregated into a single observation.

Exhibit F

Institute of Public Policy Studies Discussion Paper #280

The Competitive Advantage of a Dominant Airline

by

Severin Borenstein*

August, 1988

Abstract: Previous studies that have estimated the pricing or market share advantage of a dominant airline have suffered from the need to control for many other factors on which data are unreliable or unavailable. This paper presents an estimation approach that allows a clearer focus on the effect of airport dominance on the demand that an airline faces. The results indicate that a large presence at an airport is likely to give an airline a significant advantage in attracting customers whose trips originate at that airport. This finding may have important implications for the competitive effects of computer reservation systems, frequent flyer programs and travel agent commission override programs.

*Department of Economics and Institute of Public Policy Studies, University of Michigan, Ann Arbor, MI 48109-1220, 313-764-6133. For helpful discussions and comments, I am grateful to Jim Adams, Mark Bagnoli, Dan Kaplan, Jerry Hausman, Jeffrey MacKie-Mason, Ted Snyder, Gary Solon and participants in the University of Michigan Summer Workshop In New Economics. Janet Netz provided excellent research assistance. Financial support from the National Science Foundation is gratefully acknowledged. I alone am responsible for any errors that remain.

I. Introduction

Recent concerns about market power in the airline industry have focused in part on the effect of airport dominance in creating and protecting market power on specific routes. Dominance of one or both endpoints on a route may assist an incumbent airline in deterring entry or may give one competitor an advantage over others in the competition on a route.[1] Such an advantage might be manifest in a larger route share (in relation to share of capacity on the route) for the carrier that has a large share oftraffic or flights at the endpoint airports of the route.

Previous studies have estimated the effect of airport flight share or airport traffic share on the prices charged or the share of traffic carried by each airline on a route. These estimates, however, suffer due to the plethora of factors that will affect an airline's average price or its share of route traffic. Data for some of the causal variables are generally unavailable, so they are either omitted, possibly causing biased estimates, or proxies are used, which may yield consistency when estimated by instrumental variables, but usually still results in very noisy estimates and bias in small samples.

This paper utilizes a natural relationship between pairs of products sold by an airline to isolate the effect of airport dominance. On a given route, say Dallas - Atlanta (DFW-ATL), two types of round-trip tickets are commonly sold, those originating at Dallas and those originating at Atlanta. The former type of round trip can be described as DFW-ATL-DFW, while the latter is ATL-DFW-ATL. Each type of ticket includes one DFW to ATL journey and one ATL to DFW journey. Thus, many of the factors that vary across routes and may influence route share do not vary between these two types of round-trip tickets.

For instance, regardless of which of the two types of trips a passenger is on, she faces the carrier's flight frequency on the ATL to DFW travel exactly one time, and its flight frequency on the DFW to ATL travel one time.[2] Similar logic supports the exclusion of many other factors -

---

[1] See Morrison and Winston (1987), Levine (1987), Borenstein (1988), and Congressional Budget Office (1988).

[2] Systematic differences in the time of day at which the two different types of passengers travel a given direction on the route may still cause some asymmetry. This effect is discussed later.

attractiveness of facilities. on-time record, food quality, employee courtesy – that should be included in a cross-section estimation of the full causal model of route share. In fact, even fares rarely vary by point of origin on a route.[3]

Yet. if dominance of a passenger's originating airport is important, a comparison of this type may be quite helpful in revealing it. In the ATL-DFW market American Airlines, which dominates traffic at DFW, carries 40% of the round-trip travel on the route that originates at DFW, while it carries just 11% of round trips originating at ATL. Delta and Eastern, each with major hubs at ATL. together carry 88% of the round trips on this route that originate at ATL and 59% of those starting at DFW.

In addition to allowing the exclusion of variables that may be unavailable or poorly measured, this simplification in the estimation approach also limits the variety of plausible functional forms that should be investigated. There is, in fact, no precisely specified model that can be credibly argued to present *the* functional form that should be used to estimate the causes of route share. Thus, one would want to estimate a fairly large family of equations to observe the sensitivity of the results. Such an exercise will be more manageable when there are fewer right-hand side variables.

The results of this approach indicate that an airline that carries a large share of the traffic originating at an airport will be able to attract a disproportionate share of the traffic on any particular route from that airport. A one percentage point increase in an airline's share of all traffic originating at an airport is estimated to increase the share of local-originating traffic that the airline will carry on any particular route from the airport by as much as one-third of a percentage point.

There are many possible explanations for an airport dominance advantage, including brand-loyalty induced by frequent flyer programs (FFP's) or travel agent commission override programs

---

[3] Differences in the business/leisure mix of passengers, however, could still cause average price to vary by point of origin, an issue discussed later.

(TACO's), the "natural" reputation and information advantage from a larger presence in a city, possible economies of scale in advertising in a city, and the effect of bias in the computer reservation system (CRS) used by most of the travel agents in a city.

Unfortunately, data are available on only the last of these possible explanations, the proportion of revenues generated through sales on each of the 5 domestic CRS's at each of the 57 largest metropolitan areas in the country. Each CRS is owned by one or more airlines,[4] and it has been argued by many that the owners of a CRS systematically bias the display of flights in order to favor its own airline.[5] If this is the case, a higher market share for a CRS may cause a higher share of traffic for the airline operated by the CRS owner. The analysis gives some evidence that this is the case.

Section II discusses in greater detail reasons that an airline that dominates traffic at an airport might be able to attract a disproportionate share of the traffic on routes involving that airport. The econometric model and the method of estimation are presented in Section III. The data are discussed in Section IV. Section V presents and interprets the results of the estimation. Concluding remarks and directions for further research in this area are in Section VI.

II. Supporting Arguments for the Airport Dominance Hypothesis

The suggestion that airport dominance might lead to a competitive advantage on individual routes has received increasing attention as most of the major hub airports have come to be dominated by one or two carriers. At the same time, airlines have increased their use of certain marketing devices - FFP's, TACO's, and CRS's - that may be more effectively utilized by a company that receives frequent purchases from a customer or the largest share of a customer's purchases. The advantage may be manifest as (1) a greater preference among customers, given price and flight frequency on a route, for the dominant airline at the originating airport, or (2) the ability of the dominant carrier to credibly threaten retaliation against a potential entrant that would make the entrant's operations unprofitable. As discussed in section III, the estimation approach suggested in this paper isolates only the first of these two effects.

---

[4] In the second quarter of 1986, the period of the passenger share data used, each CRS was owned by only one company, each of which operated only one major airline at that time.

[5] See Levine (1987), Department of Transportation (1988).

A phenomenon similar to the airport dominance effect, but still distinct, was first discussed by Fruhan (1972). He showed that an airline with a large share of the available capacity on a route would generally receive a disproportionate share of the traffic on the route. The most common explanation for this effect was that passengers who want to book a flight will first call the airline that is most likely offer convenient departure times. That will generally be the airline with the most departures and, therefore, the most capacity on the route. Bailey, Graham and Kaplan (1985) also found strong evidence of this effect in 1976, but found that the effect diminished substantially by 1981 and became only marginally significant or statistically insignificant.

An explanation similar to Fruhan's is also consistent with airport dominance (as opposed to route dominance) causing a route-share advantage. If customers do not know which airlines serve a route, they might first call the airline that serves the most markets or has the most flights from their originating airport. Still, for a number of reasons this effect alone would probably be small in explaining the effect of airport dominance. First, the proportion of people who book their domestic flights without the aid of a travel agent has fallen steadily since deregulation. Between 20% and 30% of all domestic tickets are now purchased directly from the airline, down from about 50% prior to deregulation. Second, the Fruhan result is attributable in part to the fact that prior to deregulation all airlines serving a route necessarily offered the same prices. The benefits to shopping around were thus smaller than they are now; in the 1960's, calling many airlines may have located a more preferred departure time, but it would not yield a lower price as it might today. This may explain why Bailey, Graham and Kaplan found that the result had weakened substantially by 1981. Finally, if the dominant carrier attracted calls from poorly informed travelers, one would expect to see the largest effect among tourists rather than business travelers. In fact, the results presented here indicate that any difference by type of passenger goes in the opposite direction: the airport dominance effect tends to be larger on heavily business routes than on more tourist-oriented routes.

Frequent flyer programs (FFP's) are recognized as inducing brand loyalty, and may be particularly beneficial to the dominant carrier in a city. The dominant airline's service on more routes from the city implies that (1) the majority of a local resident's future flights are more likely to be on the dominant airline than any others and (2) the dominant airline is likely to serve a wider variety of "payoff" destinations from the city, destinations that are particularly attractive prizes to be awarded for blocks of accumulated mileage.[6] The importance of the former effect is a result of the non-linearity of FFP payoff functions, which encourages customers to accumulate all FFP points on as few airlines as possible.[7]

A similar non-linear payoff schedule is often employed in the commission arrangement established between an airline and the travel agents who sell its product. Travel agent commission override programs (TACO's) are contracts between an airline and a travel agent in which the airline offers to increase the agent's proportional remuneration, usually in the form of higher commission rates, if a travel agent sells more than a given quantity of travel on the airline's flights.[8] Again, this marketing device may be used most effectively by the dominant carrier at an airport for the purpose of biasing brand choice in travel purchases.[9]

Computer reservation systems (CRS's) also may be used to bias the brand choice of travel agents and thus, of consumers. Though the Civil Aeronautics Board in 1983 banned the most blatant display bias – the practice of an airline that owns a CRS listing its flights before those of other airlines – there is evidence that more subtle biases remain.[10] An airline is still perceived to have an advantage in gaining bookings from travel agents that use its CRS. In most cases where a dominant airline in a city also operates a CRS, the travel agents tend to prefer that CRS over others. Thus, CRS ownership may further enhance the advantage of a large traffic share. As mentioned above, data on the share of bookings on each CRS system by city are used to evaluate this effect.

---

[6] See Levine (1987) and Borenstein (1988) for more complete descriptions of the connection between airport dominance and FFP use

[7] The latter effect might be seen as an artificially imposed network economy. By tying travel today to future travel on "any route we serve in the U.S.," the carrier creates an option on future travel that increases in value with the variety of points served by the airline from the the FFP member's home airport.

[8] In fact, the agreements take many forms both in the payoff schedule and in the form of override payment. In some cases, override payments are based on the share of the agent's business that goes to the airline, rather than the overall volume of business with that airline. Such a system requires information on all of an agent's sales, which is more easily gathered if the agent uses the airline's CRS. Override bonuses are not always just higher monetary payment; some airlines pay off in the form of free travel or additional tickets given to the agent for which the agent can keep all revenues.

[9] See Levine (1987) and D.O.T. (1988) for more complete descriptions of TACO's and their effects.

Finally, reputation advantages may accrue to the dominant airline in a city even without the use of the new marketing techniques discussed above. Advertising, for instance, is likely to have a greater impact per dollar for an airline that serves many routes from a city than for one that serves few routes. Similarly, if travel on an airline is to some extent an experience good, then an airline offering a wide variety of products will increase the likelihood that a customer choosing a certain product will have already tried other services by that airline. Since acquiring information is costly, *ceteris perabus* the consumer may prefer the airline he has already flown. As with the Fruhan-like explanation above, however, one might expect that less experienced customers, *e.g.*, tourists, would be more affected by this incomplete information.

III. Estimation Technique and Functional Forms

The estimation of the effect of airport dominance takes advantage of the fact that many variables thought to affect route share take on the same value regardless of which end of a city-pair market is the origin of a customer's round trip. The key here is that regardless of the originating point, a round-trip traveler on the route will fly exactly once in each direction; just the order of the two directional trips will differ.[11]

Thus, if the structural equation for route share is separable in these factors, they can be eliminated from the estimation by studying the difference in an airline's share of the passengers originating at each endpoint of a route. I posit the following functional form:

---

[10] See Levine(1987), Department of Transportation (1988), U.S.D.O.T. USAir/Piedmont Acquisition Case, Docket 44719.

[11] The specific flights taken by each type of round trip traveler may differ systematically, a factor addressed below.

$$SHR_{ij} = \Gamma(X_{ij}^{1}) + \Omega(X_{ij}^{2}) + \epsilon_{ij} \tag{1}$$

where SHR_{ij} is an airline's share of the round trip traffic on the route between point i and point j that originates at point i. The first set of right-hand side variables, the vector X^1, differs within a route according to the origination point of the passenger's trip, $X_{ij}^{1} \neq X_{ji}^{1}$, while the second set of variables does not, $X_{ij}^{2} = X_{ji}^{2}$. A stochastic component of route share by point of origin, ϵ_{ij}, is also assumed. If we then consider the difference in an airline's share of traffic on a route by point of origin the second set of variables is eliminated,

$$SHR_{ij} - SHR_{ji} = \Gamma(X_{ij}^{1}) - \Gamma(X_{ji}^{1}) + \epsilon_{ij} - \epsilon_{ji}. \tag{2}$$

This equation could be estimated as a linear function, but the estimates would suffer some bias due to the limited range of the dependent variable, $[-1,1]$. Since there is no obvious functional form that presents itself, this difficulty is most easily handled with a logistic transformation of each share variable before the differencing.[12] Thus, I estimate

$$\ln\left[\frac{SHR_{ij}}{1 - SHR_{ij}}\right] - \ln\left[\frac{SHR_{ji}}{1 - SHR_{ji}}\right] = \gamma * [X_{ij}^{1} - X_{ji}^{1}] + \epsilon_{ij} - \epsilon_{ji} \quad , \tag{3}$$

with the difference between the stochastic components assumed to follow an i.i.d. normal distribution.

The logistic transformation is not defined when the variable is zero or one, however, so observations in which either directional route share, SHR_{ij} or SHR_{ji}, is zero or one must be excluded from the sample. In fact, also excluded from the results presented are routes on which the observed carrier has less than 5% or more than 95% of the total traffic on the route ($RTSHR_{ij}$). Nearly all routes excluded due the restriction from the logistic transformation would also be excluded on the second criterion. The justification for this sample selection is that if a carrier has less than 5% of the traffic it is not really an active competitor in the market, while a share of more than 95% is indicative of monopoly. In neither of these cases is the model likely to have as much predictive power. The arguments discussed in section II are much more relevant to interaction among competitors on routes with more than one significant participant.[13]

---

[12] Estimates of the linear form, equation (2), are identical in sign, but not quite as significant as estimates of (3).

A Chow test could not reject pooling across carriers and the pooled data set is significantly larger than for any individual carrier, so the pooled results are presented. By-carrier estimated parameters were generally of the same sign as the estimates from pooling, particularly for the largest carriers for which the most observations were available. Though pooling of all carriers could not be rejected, the by-carrier regressions did indicate that the larger and more sophisticated airlines may garner bigger advantages from airport dominance. For this reason, I also present results from a pool of observations for only the 4 largest domestic airlines: American, Delta, Eastern, and United.[14]

The remainder of this section discusses the variables that are in X^1, and therefore included in the regressions because of their asymmetric effect on share depending on point of origin, and in X^2, and therefore excluded from the estimation because of their symmetric effects on route share by origination point.

Asymmetric (Included) Variables that May Affect Route Share

Airport Dominance Measures - - As discussed in section II, certain marketing devices - FFP's, TACO's, and CRS's - may be most advantageous to a dominant airline in a city. In addition information economies may give a dominant airline a natural advantage in competition on routes from its dominated airport. Of course, these effects will allow an airline to attract passengers who live in a city in which the carrier is dominant, but will not have a similar effect in attracting passengers in a city that is the other endpoint of a route, where the carrier is not dominant. I measure airport dominance in a number of ways with quite consistent results. The regressions presented first use an airline's share of passengers that originate their trip at a given airport. Alternate measures include share of aircraft departures, share of seat-departures (so as to weight by plane size), and share of seat-mile-departures (so as to weight by plane size and the "size of average purchase" (distance) made by each firm's customers.) Table 4 shows results of the pooled regressions using these alternate measures.

---

[13] Other boundary restrictions, (2%,98%) and (10%,90%), yielded similar results, as shown in table 6.

[14] These are also 4 of the 5 airlines that owned a CRS in 1986, the last being TWA, which had much smaller scale domestic service.

Besides the advantage in attracting customers to its flights over a competitors', airport dominance might also allow an airline to deter entry of competitors. This could be done with a threat of retaliation, possibly made more credible due to airport dominance, or by blocking access to scarce gates or landing slots at an airport.[15] The estimation proposed here will not detect such an effect. Analysis of share difference as a function of point of origin takes as given (actually, removes in the differencing) the capacity offered by an airline and each of its competitors on a route. If, in fact, an airline were to successfully deter all entry onto a route, it would have a 100% share of the route traffic originating at each endpoint and the estimation herein would be unable to detect any airport dominance effect. This observation also suggests the boundary share restrictions on the sample that were explained above.

The differences in an airline's share of traffic on a route by point of origin will be not just a positive function of the airline's difference in airport dominance, but also a negative function of the difference in endpoint dominance of the other airlines against which it is competing on the route. Both variables are included in the regressions.

Modification of Airport Dominance Effect by Tourist Traffic - - One approach to distinguishing among the competing explanations of airport dominance advantages is to observe which kind of passengers are most strongly affected by dominance. If the cause is natural information economies, or even economies of scale in advertising, then less-frequent and less-well-informed passengers will be more likely to respond to dominance. If the cause is marketing devices designed to attract repeat business, *e.g.*, frequent flyer programs, then more-frequent travelers will be more strongly affected. Thus, the former explanations are more likely to show up on tourist-oriented routes, where a smaller proportion of the passengers are frequent travelers, while a greater effect on business routes would support the latter hypothesis.

---

[15] See *Wall Street Journal*, July 30, 1987.

Whether TACO's are more likely to bias the carrier choice of business or tourist travelers is less clear. If business travelers are better informed, then they may be able to more easily monitor travel agent behavior, so the effect of TACO's would be greater for tourist travel. On the other hand, the higher time value of business travelers may make them less likely to monitor and therefore make them more susceptible to the bias induced by TACO's. In addition, bias due to TACO's might also be greater for business travel because these programs are often used to give volume discounts to corporate customers through the firms' in-house travel agency. Overall, theory and the established institutions make ambiguous the effect that one would expect the proportion of tourist travel on a route to have on the advantage due to airport dominance.

To analyze the effect of business/touris mix, I include an interaction of the airport dominance variable with a measure of the tourist orientation of the destination city. Thus, on the L.A.-Honolulu route, for the L.A. originating passengers, this variable would be the L.A. airport share of the observed carrier multiplied by the Honolulu tourism measure. Conversely, the measure for passengers originating at Honolulu would be the carrier's Honolulu airport share times the L.A. tourism measure. The tourism interaction variable enters as modifying the both advantage of a carrier's own airport dominance and the disadvantage of the airport dominance of the competitors it faces on a route.

Computer Reservation System Share -- As explained in section II, the Department of Transportation (DOT) recently published data on the share of airline ticket revenues on each of the five CRS's in each of 57 major metropolitan areas, containing a total of 71 major commercial airports. If bias in the presentation of flights on a CRS can bias a travel agent's or passenger's decision regarding airline choice, then a dominant CRS share in a city would lead to an advantage in attracting passengers. Furthermore, if the CRS allowed an airline to more effectively implement and monitor TACO's, CRS share may reenforce the effect of airport dominance.

Still, CRS effects may be very difficult to distinguish from airport dominance effects, due to their high correlation.[16] If a large CRS share gives an airline large shares of traffic on all routes from an airport, then the airline may also display airport dominance. Similarly, if travel agents are attracted to adopt the CRS of the dominant airline in an area, the two effects will be confused. In the results presented, CRS share is generally of the expected sign, but not strongly significant. It becomes quite significant if the measures of airport dominance are removed from the regressions. As with the previous variables, both the endpoint difference in CRS share of the observed firm and the average endpoint difference in CRS share of others that it competes against on the route will affect the difference in the observed firm's route share by point of origin.

Schedule Convenience - - It was argued above that the difference in frequency of flights in either direction on a route will not affect differences in route share by point of origin, because regardless of point of origin, a round-trip journey will include one flight in each direction. Though this is true, the convenience of schedule times might affect the relative attractiveness of a carrier to customers at each endpoint of a route. For example, American might have a larger share of the Dallas-originating passengers than the Atlanta-originating passengers on the Dallas-Atlanta route, because most of its flights on the route are DFW to ATL in the morning and ATL to DFW in the evening. To control for this possible effect, an index of share of convenient flights by point of origin was constructed. Convenient flights were taken to be those nonstop flights that leave the traveler's originating point between 6 a.m. and 10 a.m. on a weekday morning plus those that depart to return to the point of origin between 4 p.m. and 8 p.m. on weekday evenings. For each market in which an airline competes, it will have a share of the convenient flights for each endpoint. The variable used to account for schedule convenience differences is the difference between endpoints in a carrier's share of the convenient flights.[17]

---

[16] Among the 71 airports for which local CRS share data are available, the correlation between origination share and CRS share is 0.71 for Eastern, 0.69 for Delta, 0.67 for TWA, 0.61 for United, and 0.68 for American.

Symmetric (Excluded) Variables that May Affect Route Share

Though the variables discussed in this section do affect the share of traffic that an airline receives on a route, they would fall into the set of X^2 variables discussed above. That is, their effects on route share would not differ substantially depending on the endpoint of a route at which a traveler begins her trip.

The logic of excluding many variables is obvious. For instance, meal quality differences among competitors may affect route share, but not by point of origin. Similarly, the attractiveness of the airport facility is not likely to have asymmetric effects, because regardless of origin point, each facility is used for one departure and one arrival on a route. Many direction-specific variables may be excluded because the round-trip traveler takes one flight in each direction. For instance, the flights in one direction on a route may tend to make more intermediate stops than in the opposite direction, but a customer would experience the imposed inconvenience in each direction one time. One variable, however, requires a more thorough discussion.

Price - The difference in shares of passengers on a route as a function of the origination point on the route is unlikely to be explained by fare differences. Fares on a route are virtually always offered without reference to the traveler's point of origin, *i.e.*, the set of DFW-ATL-DFW fares on Delta will be the same as the set of fares they offer for ATL-DFW-ATL travel. Still, if there are certain flights that are more attractive to ATL originating passengers than DFW originating passengers, *e.g.*, 7 a.m. Monday morning from ATL to DFW, a firm that dominates traffic at ATL may be able to more effectively fill these planes with full fare passengers, and so may allocate fewer discount seats to this flight than to the equivalent flight in the opposite direction, *i.e.*, 7 a.m. Monday morning from DFW to ATL. This difference in the allocation of discount seats that results from unequal demand could create differences in average price.

---

[17] Schedule convenience is likely to differ in importance depending on the length of the trip. In section V, estimates are discussed for the case in which the coefficient is restricted to be the same for all routes and when it is allowed to differ in three different distance categories.

In the all-carriers pooled data set, differences in a carrier's average price on a route by point of origin are not significantly correlated with its difference in airport origination share (correlation: 0.032), nor with the differences in origination share of competing carriers on the route (correlation: 0.003) or differences in the observed carrier's route share by point of origin (correlation: -0.028). In the big-4 carriers data set, however, these correlations are statistically significant. Differences in a carrier's average price on a route by point of origin were positively correlated with its difference in airport origination share (correlation: 0.078), negatively correlated with the differences in origination share of competing carriers on a route (correlation: -0.162) and positively correlated with differences in the observed carrier's route share by point of origin (correlation: 0.133).

The obvious problem with including price difference in the regressions is that it is clearly endogenous. In this case, a useful identifying instrument is quite difficult to find, because it must be correlated with the difference in average prices by point of origin, but not causally affected by differences in route share by endpoint. Because no useable instrument was identified, the difference in price was tried as a right-hand side variable ignoring the endogeneity; it was insignificant in every regression in which it was entered. Price difference is excluded from the regressions presented. Still, it is worth noting that positive correlations among price differences, route share differences and airport share differences by point of origin imply that the bias from omitting price difference would be to estimate smaller effects of airport dominance on route share than in fact exist.[18]

IV: The Sample and the Data

The gritty details of construction and the source of each variable are presented in the appendix. This section gives a general description of the variables and the sample. The base sample of routes from which the observations are drawn is the 1200 largest city-pair markets in the U.S. during the second quarter of 1986, the time period of the data. Of these routes, nearly 50 were removed due to severe reporting inconsistencies.[19] In the full sample that had no significant reporting problems, there were 948 routes on which at least one carrier had more than 5% of the round-trip traffic, but less than 95%.[20]

---

[18] This statement assumes that the own-price elasticity of demand faced by an individual carrier on a route is negative.

As explained above, pooling across carriers is desirable due to the scarcity of observations in the by-carrier regressions. Inclusion of all by-carrier observations in a pooled sample would be misleading, however, because some observations are for different carriers on the same route. In fact, many multi-carrier markets have just two significant competitors whose round-trip shares by point of origin sum nearly to one. Thus, not only would the assumption of independent residuals be erroneous, the information in two observations of different carriers on the same route would be virtually redundant. Pooling was done by picking randomly from the carriers on each route that met the boundary criteria.[21]

The round-trip route traffic, price, and origination share data come from the DOT's Databank 1A (DB1A), a 10% sample of all tickets sold in the U.S., in this case during the second quarter of 1986. As explained in the appendix, adjustment for reporting rate inconsistencies is done by comparison of DB1A reported enplanements to the enplanements reported in the DOT T-9 Nonstop Market Data as processed by I.P. Sharp. The T-9 is not a sample, but a complete census of every flight and every passenger that enplanes and deplanes by carrier, airport, and city-pair segment.

The city tourism index is essentially a measure of the proportion of total metropolitan income that is derived from hotels and other lodgings that serve primarily tourist or group travel. In order to get reasonable numbers for Nevada cities (where gambling income is included in hotel income) and some other locations, the index is truncated at the top end. To test for sensitivity to this somewhat arbitrary adjustment, an alternative dummy-variable approach was also used, in which cities with indices above a certain critical value were specified as tourist oriented and all others were not.[22]

---

[19] United, for instance, failed to distinguish its La Guardia Airport traffic in New York from its Kennedy Airport traffic, thus making route share calculations impossible for any route including either airport and on which United had service. On some routes, virtually no round trip tickets were reported, probably because the carriers (usually People's Express or New York Air) recorded travel only by directional journey, failing to report that two opposite directional trips on a route were part of a single round-trip ticket.

[20] This number changes when the boundary conditions for inclusion in the sample are altered, explaining the variation in number of observations in the table 3 and table 6 regressions.

[21] The loss of many observations for the pooled sample means that only those same observations could be used in the corresponding by-carrier regressions run to carry out a Chow test for pooling. This limited the power of such a test.

The data on share of CRS sales by metropolitan area is taken from the data appendix to DOT's study of the effect of CRS's. The data for construction of the schedule convenience variable are taken from the May 15, 1986 Official Airline Guide. This date is the chronological center of the second quarter of the year.

V: Results and Interpretations

The primary regression results are presented in table 2. Inclusion of the CRS data required exclusion of routes with at least one endpoint outside of the 57 metropolitan areas for which CRS data were available. Thus, the regressions that include the CRS variables have between 15% and 20% fewer observations than the equivalent regressions without CRS variables.

The strong effect of airport dominance on route share is quite apparent. The signs of the effect of an airline's own origination share (DOSH) and that of its opponents (DOSHO) are consistent and significant in every regression using the entire all-carriers or big-4 carriers sample. The regressions without CRS variables indicate that the big-4 carriers may experience a somewhat greater advantage from airport dominance (though the difference in estimates is not statistically significant), but the regressions with CRS variables indicate that this could be a false attribution of CRS advantage to airport dominance.

Ignoring for a moment the modifying effect of the tourism interaction terms, the results generally indicate that a one percentage point increase in share of originating passengers at the endpoint will yield a 0.7 to 1.3 change in the logistically transformed dependent variable which translates to a route share increase of up to 0.18-0.33 percentage points.[23] This will be the case if the gain in airport share is not at the expense of opponents on a route. If all gains in airport share are taken from an airline that competes on the same routes, then a one percentage point increase in airport share could increase route share by as much as two-thirds of a percentage point.

---

[22] The dummy-variable approach is similar to that used by Graham, Kaplan, and Sibley, except that I exclude some Florida cities that are not very tourist oriented e.g., Tallahassee) and I include some cities outside Nevada, Hawaii, and Florida (e.g., Monterey, CA and Myrtle Beach, SC). See the appendix for details. The results of this alternative approach, shown in table 5, are consistent with the primary specification of the model.

Table 3 presents an attempt to trace out somewhat more precisely the effect of airport dominance on route share. The estimates in this table are from a piecewise linear model of the effect of origination share on the logistically transformed dependent variable. The tourism modifying effects and CRS effects are omitted, because the colinearity of these variables made all estimates insignificant with very large standard errors. The table indicates that changes in airport share are likely to have the largest effects on route share when the carrier's has from 0% to 20% of the airport originations (DOSH02, DOSHO02). The marginal effect appears to be smaller for airport shares in the 20% to 40% range (DOSH24, DOSHO24), but then again increases and is fairly statistically significant in the 40% to 60% range (DOSH46, DOSHO46). The small number of observations in the highest range (DOSH6+, DOSHO6+) make these results statistically unreliable. One might interpret the effect in the 0% to 20% range as an effect of presence, which may be more attributable to information advantages, while the 40% to 60% marginal effect could be due to dominance and more attributable to loyalty-inducing marketing devices. Many other interpretations are, of course, also possible.

The average value of the tourism index is about 0.01, with a range from virtually zero to 0.07. With a parameter estimate of, for instance, −12 on the tourism/airport share interaction term (DTOSH), the advantage of airport dominance would be about one-third as great on the most tourist oriented routes as compared to completely non-tourist routes.[24] The impact of the tourism interaction term is consistent in sign and fairly consistent in magnitude throughout th tables. The significance of these estimates varies, depending particularly on the presence of the CRS variables, with which both the airport share and the tourism/airport share variables are colinear. The dummy-variable approach to estimation of the tourism modifying effect (table 5) is consistent with the tourist index approach; the estimates imply that the airport share advantage is about one-third to two-thirds less on tourist-oriented routes than on business-oriented routes. Though these estimates are not always significant, they still give greater support to the FFP (and, perhaps, TACO) explanations for the importance of airport dominance than to the costly information and economies of scale in advertising hypotheses. Of course, all of these theories probably hold some piece of the explanation, but the results indicate that the new marketing devices are probably at least as important as the information and advertising effects.

---

[23] The derivative of route share with respect to a change the logistically transformed share variable depends on the level of the share variable. The derivative is a parabolic function with the maximum value when share is 50% and minima when share is 0% or 100%. To give some idea of the range, the derivative is 0.25 when share is 50%, 0.24 when share is 40% or 60%. 0.1ν when share is 25% or 75%, 0.09 when share is 10% or 90%, and 0 when share is 0% or 100%. The upper bound estimates presented in the text are 0.25 times the range of parameter estimates for DOSH, roughly 0.7 to 1.3.

The effect of computer reservation systems on route share may be captured to a large extent in the airport share measure. Still, there are some cities where a certain CRS is used by many of the travel agents even though the owner-airline is not very active at the local airport. The estimates are fairly consistent in sign, indicating the a larger CRS share increases route share, but the magnitude and significance of these estimates vary quite a bit.[25] Even the largest estimates, around 0.3, indicate that a one percentage point increase in CRS share would have a direct effect on route share of no more than 0.07 percentage points. Of course, the greater ability to utilize TACO's and to otherwise influence travel agents through the CRS may increase a CRS-owning airline's overall airport share, thereby indirectly increasing share on specific routes.

Finally, the schedule convenience variable has the anticipated sign and is strongly significant in all of the pooled regressions. As discussed above, one might expect this variable to be a more important factor for short distance trips than for longer trips, where one-day round-trip travel is not common. To test for sensitivity of the results to this possible misspecification, three different parameters were estimated for, respectively, routes of less than 500 miles, 500 to 1500 miles, and greater than 1500 miles. Indeed, the parameter is largest and most significant for the shortest distance category.[26] Still, the restriction to a common parameter could not be rejected by an F-test and, more importantly, the more flexible form had almost no impact on the estimates of airport share effects – less than a 10% change in the parameter estimate in all cases and less than 1% in most cases. The insensitivity of the other parameter estimates to the form of the schedule convenience variable is explained by the fact that schedule convenience is not significantly correlated with airport share or CRS share. Airlines are about as likely to have conveniently scheduled flights for people traveling to their dominated airports as for customers originating at their dominated airports.[27]

---

[24] 0.07 multiplied by −12 implies a decrease in the impact of airport dominance of about 0.84, or about two-thirds of the average parameter estimate for DOSH.

[25] The fact that the CRS variables become larger and more significant when alternative measures of airport share are used (table 4) is probably more an endorsement of origination share as the best airport dominance measure than an indication that these are better estimates of CRS effect.

Evidence on a "Knife-Edge" Explanation of the Airport Share Advantage

A critical examiner of the results presented thus far might argue that some airport share advantage is evident, but that the magnitude of that advantage is still difficult to assess. The reason for this conclusion would be that the results presented above do not indicate the price differential that would allow a firm with small airport share to overcome the advantage to a locally dominant airline.

An extreme version of this view would be that a competitive equilibrium among only slightly differentiated firms may leave many customers nearly indifferent among them. As a result, a small change in attractiveness, such as might flow from airport dominance, could induce quite asymmetric market shares. This result would not then be evidence that the competitively disadvantaged firms could not compete by charging only slightly lower prices or that the threat of such competition would not force the advantaged firm to still charge prices very close to a competitive level.

---

[26] Curiously, however, the middle distance category showed smaller and less significant estimates than for long distance, where the effect was nearly as large as for the short distance category.

[27] The one exception to this finding is the -0.062 correlation (significant at the 6% level) between DSCHD and DOSH in the all-carriers data set. A negative correlation, however, indicates more convenient service for those whose trips are to the dominated airport.

Ideally, one would respond to this argument by estimating the tradeoff between price differentials and airport share differentials in affecting route shares. As explained above, however, average price varies little if at all by point of origin on a route and the effect of price is endogenous with little hope of identification in the specification estimated here. The approach of this paper is therefore not useful in estimating the rate at which price differentials among firms may be used to compensate for airport share differentials.[28]

Still, if airport share advantages were easily overcome by price competition, one would expect to see a relationship between airport share and directional route share only (or much more strongly) on routes where carriers charge approximately the same prices. When prices differ greatly, dominance at an airport would be of much less consequence. To analyze this effect, table 7 presents regressions with the all-carriers data set stratified by the ratio of the average price of the observed carrier to the average price charged by all other airlines serving the route. The observations have been broken into three groups of approximately equal size. Observations with small price differentials among competitors are those in which the observed airline's average price is within about 7% of the average price of all others, $0.93 < PRICE^{a}/PRICE^{-a} < 1.07$, where a references the observed airline. Medium price differentials are approximately from 7% to 18% and large price differentials are greater than 18%.

The effect of changes in airport share on route share seems to be quite consistent across the three categories.[29] The marginal effect on route share due to airport dominance is significant even when competitors are charging very different prices. These price differences between competitors are, of course, endogenous. Nonetheless, table 7 indicates that in the equilibria we observe, regardless of price differences between firms, differences in route share by point of origin are strongly associated with differences in airport share.[20] This comparison does not indicate the effectiveness with which fare discounting can be used to overcome airport share advantages, but it suggests strongly that airport dominance is a significant part of airline competition even when prices among competitors differ substantially.

---

[28] Other studies have estimated significant price premia charged by airlines that dominate airports or routes. See Morrison and Winston (1987), Bailey and Williams (1988), and Borenstein (1988).

[29] Similarly stratified regressions using the big-4 carriers data set also show a consistent effect.

VI: Conclusion

The structure of the analysis used in this paper has allowed a clear examination of some of the effects of airport dominance in airline competition. The result is strong evidence of the competitive advantage gained from a large airport share. There is also evidence that this advantage is greater in attracting business travelers than pleasure travelers, indicating that at least some of the advantage may come from frequent flyer plans and other loyalty-inducing devices. Separate analysis of the effect of computer reservation systems indicates that these too may give some advantage to an airline, though the results are not statistically very strong.

Whether the competitive advantage of airport dominance is due primarily to marketing devices or to natural reputation advantages, the results presented here indicate that small scale entry into an airport may be exceedingly difficult, even if the entrant has lower costs than the incumbent. In order to overcome this disadvantage, a new entrant would have to launch a large operation at an airport where another carrier has already established a hub. The large sunk costs of such an operation and the short-run blood letting that would surely follow seem likely to discourage all, but the most aggressive upstarts from entering an airport dominated by any, but the most slovenly incumbents.

---

[20] If price differences between competitors reflected merely hedonic pricing of quality differences, then the stratification in table 7 would not answer the criticism explained above. Rather, one could argue that a firm without much airport share could overcome that disadvantage by dropping its price only slightly below the quality-adjusted competitive price that it would charge if there were no airport share advantage. The argument is difficult to support in this case, however, because the firms that are generally perceived to be high-quality, *e.g.*, American, Delta, or United, do not systematically charge higher average prices than the airlines against which they are competing in a market, while only People's Express appears to systematically charge much lower average prices (more than 10% lower) than the firms against which it competes.

Data Appendix

SHR^{a}_{ij} : Directional route share. Share of round trip tickets, i-j-i, sold by airline a, where i and j index airports. Source: DB1A as adjusted using T-9, USDOT.

$LDSHR^{a}_{ij}$:

$$LDSHR^{a}_{ij} = \ln[\frac{SHR^{a}_{ij}}{1 - SHR^{a}_{ij}}] - \ln[\frac{SHR^{a}_{ji}}{1 - SHR^{a}_{ji}}]$$

$RTSHR^{a}_{ij}$: Route share. Carrier a's share of all round trip tickets in the ij market. Source: DB1A as adjusted using T-9, USDOT.

OSH^{a}_{i} : The share of passengers originating any ticket at airport i whose first flight segment is on airline a. Source: DB1A as adjusted using T-9, USDOT.

$OSHO^{-a}_{ij}$: Weighted average of OSH_i for all carriers other than a that serve the observed route. Weights are the directional route share (SHR_{ij}) of each competing carrier on the observed route (rescaled so weights add to 1). Source: DB1A as adjusted using T-9, USDOT.

$DOSH^{a}_{ij}$. $DOSHO^{-a}_{ij}$: $OSH^{a}_{i} - OSH^{a}_{j}$, $OSHO^{-a}_{ij} - OSHO^{-a}_{ji}$.

$TOSH^{a}_{i}$: OSH^{a}_{i} multiplied by $TRINX_j$.

$TOSHO^{-a}_{ij}$: $OSHO^{-a}_{ij}$ multiplied by $TRINX_j$.

$DTOSH^{a}_{ij}$, $DTOSHO^{-a}_{ij}$: $TOSH^{a}_{i} - TOSH^{a}_{j}$, $TOSHO^{-a}_{i} - TOSHO^{-a}$.

$DTDUM^{a}_{ij}$: same as $DTOSH^{a}_{ij}$ except using $TDUM_j$ in place of $TRINX_j$.

$DTDUMO^{-a}_{ij}$: same as $DTOSHO^{-a}_{ij}$ except using $TDUM_j$ in place of $TRINX_j$.

CSH^{a}_{i} : The share of computer reservation system revenues in the metropolitan area of airport i that are generated on the CRS owned by airline a, equals zero if the observed airline did not own a CRS in 1986. Source: USDOT (1988).

$CSHO^{-a}_{ij}$: Weighted average of CSH_i for all carriers other than a that serve the observed route. Weights are the directional route share (SHR_{ij}) of each competing carrier on the observed route (rescaled so weights add to 1). Source: USDOT (1988) and DB1A as adjusted using T-9, USDOT.

$DCSH^{a}_{ij}$, $DCSHO^{-a}_{ij}$: $CSH^{a}_{i} - CSH^{a}_{j}$, $CSHO^{-a}_{ij} - CSHO^{-a}_{ji}$.

$SCHD^{a}_{ij}$: A carrier's share of the conveniently scheduled nonstop flights for round-trip travel between airports i and j of the type i-j-i. Conveniently scheduled flights are those on weekdays that leave to fly i-j between 6 a.m. and 10 a.m. plus those that leave to fly j-i between 4 p.m. and 8 p.m. If their were no conveniently scheduled flights for ij or no conveniently scheduled flights for ji, then $SCHD^{a}_{ij}$ or $SCHD^{a}_{ji}$ were undefined. In that case, $SCHD_{ij}$ and $SCHD_{ji}$ were set to missing values and $DSCHD_{ij}$ was set to zero for all carriers on the route. Source: Official Airline Guide, May 15, 1986.

$DSCHD_{ij}^{a}$: $SCHD_{ij}^{a} - SCHD_{ji}^{a}$.

AD : Used in place of OSH as a variable name and as part of other variable names. Same as OSH, but replaces a carrier's share of passengers originating at an airport with its share of aircraft departures from the airport. **Source:** T-9 Nonstop Market Data, USDOT.

SD : Used in place of OSH as a variable name and as part of other variable names. Same as OSH, but replaces a carrier's share of passengers originating at an airport with its share of seat-departures (aircraft departure multiplied by number of seats on the aircraft) from the airport. **Source:** T-9 Nonstop Market Data, USDOT.

SMD : Used in place of OSH as a variable name and as part of other variable names. Same as OSH, but replaces a carrier's share of passengers originating at an airport with its share of nonstop seat-mile-departures (aircraft departure multiplied by number of seats on the aircraft multiplied by distance of first nonstop segment flown from the airport) from the airport. **Source:** T-9 Nonstop Market Data, USDOT.

$PRICE_{ij}^{a}$: Average price charged by carrier a for round-trip travel on route i-j. **Source:** DB1A as adjusted using T-9, USDOT.

$PRICE_{ij}^{-a}$: Weighted average of $PRICE_{ij}$ for all carriers other than a that serve the observed route. Weights are the directional route share (SHR_{ij}) of each competing carrier on the observed route (rescaled so weights add to 1). **Source:** DB1A as adjusted using T-9. USDOT.

$TRINX_i$: Index of the tourist orientation of the traffic served by a given airport, based on data on the metropolitan area (or county if not in an SMSA) around the airport. Numerator is the total Hotel, Motel and Motor Hotel Revenues multiplied by the proportion of hotels in the state who reported in a 1977 survey that they serve primarily Tourist or Group/Convention business (Table 10 of 1977 Census of Service Industries). Denominator is total Personal Income in the area. If ratio is greater than 0.07 then $TRINX_i = 0.07$. **Source:** Census of Service Industries (1977, 1982), State and Metropolitan Area Data Book (1982).

$TDUM_i$: Dummy variable designation of airport i as a primarily tourist destination or not, equal 1 if tourist index of the airport ($TRINX_i$) is greater that 0.023, 0 otherwise. Airports designated as primarily tourist destinations that are part of at least one route in the top 1200 are Las Vegas, Reno, all Hawaii airports, all Florida airports except Jacksonville and Tallahassee, Billings, MT, Monterey, CA, Myrtle Beach, SC and Casper, WY.

Explanation of Reporting Rate Adjustment - Though the DB1A is supposed to be a 10% sample of all tickets sold by a carrier, reporting rates are not consistently 10%. The T-9 Nonstop Data Set, however, allows for some correction when inconsistencies are found. The T-9 is a complete census of passengers on every flight segment of every airline. Thus, the number of people reported in the DB1A to be boarding flights at a given airport by a given airline should be 10% of the T-9 census figure. If the DB1A figure is not 10% of the figure calculated from the T-9, then every report of passengers originating at the airport is adjusted by the proportion of the DB1A to the T-9 figure.

For example, assume that the T-9 reports that 750,000 passengers boarded United flights at O'Hare airport during the quarter, but only 50,000 passenger tickets with O'Hare boardings on United were reported in the DB1A. Full 10% reporting would show 75,000 of these tickets in the DB1A.[31] To correct for this error, every count of passengers on a given itinerary/fare combination that appears in the DB1A and originates at O'Hare is scaled up by 75,000/50,000 or a factor of 1.5.[32]

---

[31] This assumes that the T-9 is accurate. Because it is a simple head count of boardings and passengers on board, it is generally considered to be a very reliable report.

[32] This process closely mimics the one used by Boeing Computer Services in their adjustment of passenger counts for reporting rate inconsistencies. Though I have not carried out the statistical analysis reported in this paper on unadjusted data, the same pattern of asymmetric route shares by point of origin and its relationship to airport dominance is evident in the unadjusted data.

REFERENCES

Bailey, Elizabeth E., David R. Graham, and Daniel P. Kaplan (1985). *Deregulating the Airlines*, Cambridge, MA: MIT Press.

Bailey, Elizabeth E. and Jeffrey R. Williams (1988). "Sources of Economic Rent in the Deregulated Airline Industry," *Journal of Law and Economics*.

Borenstein, Severin J. (1988). "Hubs and High Fares: Airport Dominance and Market Power in the U.S. Airline Industry," Institute of Public Policy Studies Discussion Paper #278, University of Michigan, March.

Call, Gregory D. and Theodore E. Keeler (1985). "Airline Deregulation, Fares, and Market Behavior: Some Empirical Evidence," in A.F. Daughety ed., *Analytic Studies in Transport Economics*, Cambridge: Cambridge University Press.

Fruhan, W.E. Jr. (1972). *The Fight for Competitive Advantage: A Study of the United States Domestic Trunk Carriers*, Boston, MA: Harvard University Graduate School of Business Administration, 1972.

Graham, David R., Daniel P. Kaplan, and David S. Sibley (1983). "Efficiency and Competition in the Airline Industry," *Bell Journal of Economics*, Spring.

Levine, Michael E. (1987). "Airline Competition in Deregulated Markets: Theory, Firm Strategy and Public Policy," *Yale Journal on Regulation*, July.

Moore, Thomas G. (1986). "U.S. Airline Deregulation: It's Effect on Passengers, Capital and Labor," *Journal of Law and Economics*, April.

Morrison, Steven A. and Clifford Winston (1986). *The Economic Effects of Airline Deregulation*, Washington, D.C.: Brookings.

Morrison, Steven A. and Clifford Winston (1987). "Empirical Implications and Tests of the Contestability Hypothesis," *Journal of Law and Economics*, April.

U.S. Congressional Budget Office (1988). *Policies for the Deregulated Airline Industry*, July.

U.S. Department of Transportation (1988). *Study of Airline Computer Reservation Systems*, May

"An Unexpected Result of Airline Decontrol is Return to Monopolies: Big Carriers Are Dominating Nation's Hub Airports; Legislators are Concerned," *Wall Street Journal*, July 20, 1987 p. 1,6.

TABLE 1
DESCRIPTIVE STATISTICS

Pool of Observations on All Carriers

VARIABLE	N	MEAN	STANDARD DEVIATION	MINIMUM VALUE	MAXIMUM VALUE
SHR	1896	.352273	.261573	.004000	.980000
OSH	1896	.149216	.136737	.001000	.737000
TOSH	1896	.002198	.004198	.000004	.037590
CSH	1574	.162826	.243533	.000000	.915000
OSHO	1896	.162215	.124736	.004000	.858000
TOSHO	1896	.002348	.003740	.000019	.032736
CSHO	1574	.168729	.181099	.000000	.915000
SCHD	1168	.338199	.320441	.000000	1.000000
LDSH	948	.019315	.768471	-3.625719	6.088036
DOSH	948	.019775	.196967	-.564000	.504000
DTOSH	948	.000475	.005510	-.029094	.037012
DCSH	787	.022839	.223920	-.765000	.880000
DOSHO	948	.008493	.181198	-.818000	.450000
DTOSHO	948	.000160	.004703	-.030137	.031185
DCSHO	787	.020657	.170394	-.633000	.748000
DSCHD	948	-.005234	.157335	-1.000000	1.000000

Pool of Observations on Big-4 Carriers

VARIABLE	N	MEAN	STANDARD DEVIATION	MINIMUM VALUE	MAXIMUM VALUE
SHR	1562	.341542	.245130	.006000	.980000
OSH	1562	.180341	.135230	.004000	.858000
TOSH	1562	.002572	.004024	.000031	.035210
CSH	1300	.321416	.254353	.002000	.915000
OSHO	1562	.148847	.122607	.009000	.819000
TOSHO	1562	.002186	.003395	.000034	.034510
CSHO	1300	.127902	.155615	.000000	.915000
SCHD	902	.333823	.317076	.000000	1.000000
LDSH	781	.064392	.755968	-3.625719	3.531421
DOSH	781	.052499	.194440	-.435000	.496000
DTOSH	781	.000775	.005838	-.030137	.035063
DCSH	650	.038632	.292620	-.714000	.880000
DOSHO	781	-.001200	.185305	-.752000	.487000
DTOSHO	781	.000286	.005133	-.027156	.034249
DCSHO	650	.009071	.137273	-.480000	.574000
DSCHD	781	-.002714	.160567	-1.000000	1.000000

Notes: Observations on undifferenced variables for each endpoint (e.g. OSH1 and OSH2) are presented together in this table (e.g. as OSH).

See data appendix for explanation of variations in number of observations.

TABLE 2

Dependent Variable: LDSHR

	Pool of Observations on All Carriers			Pool of Observations on Big-4 Carriers		
INTERCEPT	0.01	0.01	0.02	0.01	0.00	0.01
	(0.02)	(0.02)	(0.03)	(0.03)	(0.03)	(0.03)
DOSH	0.99 a	1.17 a	1.16 a	1.11 a	1.33 a	1.09 a
	(0.12)	(0.15)	(0.19)	(0.13)	(0.16)	(0.23)
DTOSH		-12.60 b	-15.16 b		-14.09 b	-8.72
		(6.06)	(7.24)		(5.99)	(6.83)
DCSH			0.16			0.25 c
			(0.14)			(0.14)
DOSHO	-0.93 a	-1.17 a	-1.24 a	-1.13 a	-1.32 a	-1.35 a
	(0.13)	(0.16)	(0.20)	(0.13)	(0.17)	(0.21)
DTOSHO		17.46 b	14.98 c		14.04 c	14.79 c
		(6.94)	(7.97)		(7.31)	(8.01)
DCSHO			0.01			-0.21
			(0.18)			(0.24)
DSCHD	0.71 a	0.74 a	0.77 a	0.69 a	0.70 a	0.69 a
	(0.15)	(0.15)	(0.17)	(0.15)	(0.15)	(0.16)
OBSERVATIONS	948	948	787	781	781	650
R-SQUARE	0.138	0.144	0.157	0.202	0.209	0.241
F RATIO	50.18 a	31.68 a	20.70 a	65.76 a	40.84 a	29.04 a

DOSH(O) - Difference between route endpoints of carrier's share of passenger trip originations at each airport.

DTOSH(O) - Difference between route endpoints of carrier's share of passenger trip originations at the airport multiplied by the tourism index of the opposite endpoint airport.

DCSH(O) - Difference between route endpoints of carrier's share of computer reservation system revenues in the metropolitan area of each ariport.

DSCHD - Difference in share of conveniently scheduled flights on the route for travelers on the route originating at each of endpoint airports.

O' at end of variable name indicates weighted average of variable value for all airlines that compete with the observed airline on the observed route.

a - Significant 1% level b - Sig at 5% level c - Sig at 10% level

TABLE 3
Piecewise Linear Estimation of the Effect of Origination Share

Dependent Variable: LDSHR

	Pool of Observations on All Carriers	Pool of Observations on Big-4 Carriers
INTERCEPT	0.02 (0.02)	0.01 (0.03)
DOSH02	2.30 a (0.33)	1.76 a (0.33)
DOSH24	-0.64 (0.43)	0.36 (0.39)
DOSH46	2.16 b (0.86)	1.78 b (0.86)
DOSH6+	-5.27 (4.58)	-2.34 (2.58)
DOSHO02	-1.21 a (0.33)	-1.45 a (0.34)
DOSHO24	-0.69 (0.42)	-0.81 c (0.49)
DOSHO46	-1.76 b (1.06)	-0.97 (1.14)
DOSH6+	0.71 (1.68)	-2.04 (3.08)
DSCHD	0.72 a (0.15)	0.73 a (0.15)
OBSERVATIONS	948	781
R-SQUARE	0.159	0.211
F RATIO	19.63 a	22.93 a

a = Significant 1% level b = Sig at 5% level c = Sig at 10% level

TABLE 4
Regressions Using Alternate Measures of Airport Dominance
Pool of Observations on All Carriers

Dependent Variable: LDSHR

INTRCPT	0.02	INTRCPT	0.02	INTRCPT	0.02	INTRCPT	0.02
	(0.03)		(0.03)		(0.03)		(0.03)
DOSH	1.16 a	DAD	0.76 a	DSD	0.71 a	DSMD	0.60 a
	(0.19)		(0.16)		(0.16)		(0.15)
DTOSH	-15.16 b	DTAD	-12.86 b	DTSD	-11.85 c	DTSMD	-9.28 c
	(7.24)		(6.41)		(6.04)		(5.45)
DCSH	0.16	DCSH	0.29 b	DCSH	0.29 c	DCSH	0.31 b
	(0.14)		(0.14)		(0.15)		(0.15)
DOSHO	-1.24 a	DADO	-0.72 a	DSDO	-0.77 a	DSMDO	-0.75 a
	(0.20)		(0.16)		(0.16)		(0.15)
DTOSHO	14.98 c	DTADO	12.22 c	DTSDO	12.37 c	DTSMDO	11.22 c
	(7.97)		(6.85)		(6.61)		(6.33)
DCSHO	0.01	DCSHO	-0.19	DCSHO	-0.12	DCSHO	-0.06
	(0.18)		(0.18)		(0.19)		(0.19)
DSCHD	0.77 a	DSCHD	0.79 a	DSCHD	0.79 a	DSCHD	0.78 a
	(0.17)		(0.18)		(0.17)		(0.18)
OBS	787	OBS	787	OBS	787	OBS	787
R-SQ	0.157	R-SQ	0.113	R-SQ	0.116	R-SQ	0.113
F	20.70 a	F	14.14 a	F	14.58 a	F	14.10 a

Correlation Matrices of Airport Dominance Measures

	DSD	DSMD	DOSH
DAD	0.99 a	0.94 a	0.93 a
DSD		0.97 a	0.95 a
DSMD			0.92 a

	DSDO	DSMDO	DOSHO
DADO	0.99 a	0.95 a	0.92 a
DSDO		0.98 a	0.95 a
DSMDO			0.92 a

AD = In place of OSH, the share of aircraft departures from an airport.

SD = In place of OSH, the share of seat departures from an airport.

SMD = In place of OSH, the share of seat-mile departures from an airport.

See Appendix for futher explanation.

a = Significant 1% level b = Sig at 5% level c = Sig at 10% level

TABLE 5
Regressions Using Tourism Dummy Instead of Tourism Index

Dependent Variable: LDSHR

	Pool of Observations on All Carriers		Pool of Observations on Big-4 Carriers	
INTERCEPT	0.01 (0.02)	0.02 (0.03)	0.00 (0.03)	0.01 (0.03)
DOSH	1.06 a (0.13)	1.04 a (0.16)	1.19 a (0.13)	1.04 a (0.21)
DTDUM	-0.46 c (0.27)	-0.69 b (0.32)	-0.46 c (0.25)	-0.45 (0.31)
DCSH		0.17 (0.14)		0.25 c (0.14)
DOSHO	-1.03 a (0.14)	-1.15 a (0.17)	-1.18 a (0.14)	-1.23 a (0.18)
DTDUMO	0.66 b (0.28)	0.73 b (0.35)	0.36 (0.30)	0.60 c (0.34)
DCSHO		0.03 (0.19)		-0.21 (0.24)
DSCHD	0.73 a (0.15)	0.76 a (0.17)	0.70 a (0.15)	0.68 a (0.16)
OBSERVATIONS	948	787	781	650
R-SQUARE	0.143	0.158	0.206	0.240
F RATIO	31.40 a	20.80 a	40.18 a	29.00 a

DTDUM(O) = Difference between route endpoints of carrier's share of passenger trip originations at the airport multiplied by one if the opposite endpoint airport has been designated tourist under the dummy variable tourist approach, multiplied by zero otherwise.

a = Significant 1% level b = Sig at 5% level c = Sig at 10% level

TABLE 6
Regressions Using Alternate Route Share Criteria for Inclusion
Pool of Observations on All Carriers

Dependent Variable: LDSHR

	Criterion for Inclusion: 0.02 < Route Share < 0.98			Criterion for Inclusion: 0.1 < Route Share < 0.9		
INTERCEPT	0.02 (0.02)	0.02 (0.02)	0.03 (0.03)	-0.00 (0.02)	-0.00 (0.02)	0.00 (0.02)
DOSH	1.08 a (0.13)	1.24 a (0.16)	1.21 a (0.21)	1.04 a (0.10)	1.18 a (0.13)	1.22 a (0.15)
DTOSH		-11.42 c (6.47)	-14.17 c (7.81)		-10.46 b (5.17)	-12.11 b (5.90)
DCSH			0.14 (0.16)			0.04 (0.12)
DOSHO	-0.98 a (0.13)	-1.18 a (0.16)	-1.08 a (0.21)	-0.85 a (0.12)	-1.09 a (0.15)	-1.02 a (0.19)
DTOSHO		15.04 b (6.84)	5.82 (8.03)		16.96 a (6.49)	9.57 (7.41)
DCSHO			-0.09 (0.19)			-0.11 (0.16)
DSCHD	0.69 a (0.17)	0.72 a (0.17)	0.71 a (0.20)	0.67 a (0.12)	0.70 a (0.12)	0.70 a (0.13)
OBSERVATIONS	983	983	813	912	912	758
R-SQUARE	0.138	0.143	0.143	0.174	0.180	0.197
F RATIO	52.35 a	32.60 a	19.11 a	63.70 a	39.88 a	26.19 a

a = Significant 1% level   b = Sig at 5% level   c = Sig at 10% level

TABLE 7
Regressions Stratified by Price Differences Among Competitors
Pool of Observations on All Carriers

Dependent Variable: LDSHR

	Small Average Price Differences		Medium Average Price Differences		Large Average Price Differences	
INTERCEPT	0.02 (0.04)	0.02 (0.04)	-0.00 (0.04)	-0.02 (0.05)	0.03 (0.04)	0.03 (0.05)
DOSH	1.41 a (0.24)	1.16 a (0.32)	1.03 a (0.28)	1.15 a (0.36)	1.10 a (0.26)	1.20 a (0.32)
DTOSH	-10.75 (9.25)	-11.07 (12.05)	-10.34 (12.22)	-10.54 (13.13)	-20.65 c (10.66)	-28.72 b (13.41)
DCSH		0.51 b (0.25)		0.03 (0.25)		0.00 (0.27)
DOSHO	-1.43 a (0.26)	-1.45 a (0.32)	-1.20 a (0.30)	-1.53 a (0.37)	-0.91 a (0.27)	-0.66 c (0.36)
DTOSHO	28.57 b (11.92)	24.07 (15.59)	8.60 (13.51)	4.91 (14.75)	15.09 (11.02)	16.07 (12.15)
DCSHO		0.09 (0.30)		0.36 (0.33)		-0.43 (0.33)
DSCHD	0.86 a (0.23)	0.90 a (0.26)	0.68 b (0.29)	0.65 b (0.30)	0.72 a (0.25)	0.87 b (0.35)
OBSERVATIONS	316	262	316	263	316	262
R-SQUARE	0.211	0.235	0.139	0.168	0.103	0.114
F RATIO	16.61 a	11.17 a	9.97 a	7.37 a	7.13 a	4.67 a

a = Significant 1% level   b = Sig at 5% level   c = Sig at 10% level

Exhibit 6
Page 1 of 3

Docket [illegible]
Exhibit AWA-917-R
Page 1 of 1

America West Airlines

COMPARISON OF ACTUAL VS INDUSTRY AVERAGE FARES AT HUBS OF JAPAN CASE CARRIERS

YE 3Q89

HUB - A/L	# MKTS	# PAX	AVG TRIP	AVG FARE ACTUAL	AVG FARE INDUST	ACTUAL AS % OF INDUST
ATLANTA	824	12,188,570	755	162.35	127.97	127
DL-ATL	97	7,963,900	740	172.50	126.91	136
EA-ATL	67	1,867,920	666	127.97	123.29	104
OTHER	660	2,356,750	873	155.33	135.26	115
CHICAGO (ORD/MDW)	1,311	25,215,140	864	144.12	136.60	106
AA-ORD	96	5,152,940	933	165.04	142.71	116
ML-MDW	50	2,805,280	710	110.06	126.60	87
UA-ORD	99	9,434,090	950	164.43	144.51	114
OTHER	1,066	7,822,830	769	118.07	126.62	93
DALLAS (DFW/DAL)	791	17,158,260	723	132.96	124.54	107
AA-DFW	97	6,741,920	863	169.51	138.54	122
DL-DFW	94	3,419,580	823	149.85	134.27	112
WN-DAL	30	4,423,270	291	51.30	83.94	61
OTHER	570	2,573,490	967	155.13	144.70	107
DENVER	835	10,736,020	1,027	157.85	152.13	104
CO-DEN	75	3,654,860	999	156.77	150.66	104
UA-DEN	100	4,551,360	1,053	165.70	155.79	106
OTHER	660	2,529,800	1,020	145.30	147.66	98
PHOENIX	804	12,738,850	877	95.51	134.58	71
HP-PHX	43	4,409,500	568	68.67	111.88	61
WN-PHX	26	3,056,940	494	59.07	105.94	56
OTHER	735	5,272,410	1,358	139.08	170.18	82
ST. LOUIS	766	7,193,610	761	130.48	128.88	101
TW-STL	81	4,550,930	811	140.58	134.86	104
OTHER	685	2,642,680	675	113.08	118.63	95

Note: Industry average fare based on airport pairs with >= 10,000 annual O&D.
Carrier/Hub analysis based on top 100 O&D airport markets for each hub.

Rebuttal to AA-T-1, CO-T-1 and DL-T-1.

SOURCE: Database Products, Inc.

Exhibit G
Page 2 of 3

Docket 46700
Exhibit AWA-918-R
Page 1 of 2

America West Airlines

COMPARISON OF HUB CARRIERS' AVERAGE FARES IN MARKETS WITH/WITHOUT COMPETITION FROM A LOWER FARE CARRIER

A. Chicago (ORD/MDW)

HUB - A/L	# MKTS	# PAX	AVG TRIP	AVG FARE		ACTUAL AS % OF INDUST
				ACTUAL	INDUST	
American Airlines						
Markets Where AA:						
Does Not Compete With ML	63	2,280,730	1,132	185.05	157.16	118
Competes with ML	33	2,872,210	776	149.15	131.24	114
All Markets	96	5,152,940	933	165.04	142.71	116
United Airlines						
Markets Where UA:						
Does Not Compete With ML	66	4,172,720	1,117	191.94	155.68	123
Competes with ML	33	5,261,370	817	142.62	135.65	105
All Markets	99	9,434,090	950	164.43	144.51	114
Midway Airlines - All Mkts	50	2,805,280	710	110.06	126.60	87
TOTAL CHICAGO	1,311	25,215,140	864	144.12	136.60	106

Exhibit G
Page 3 of 3

Docket 46700
Exhibit AWA-918-R
Page 2 of 2

America West Airlines

COMPARISON OF HUB CARRIERS' AVERAGE FARES IN MARKETS
WITH/WITHOUT COMPETITION FROM A LOWER FARE CARRIER

B. Dallas/Ft. Worth (DFW/DAL)

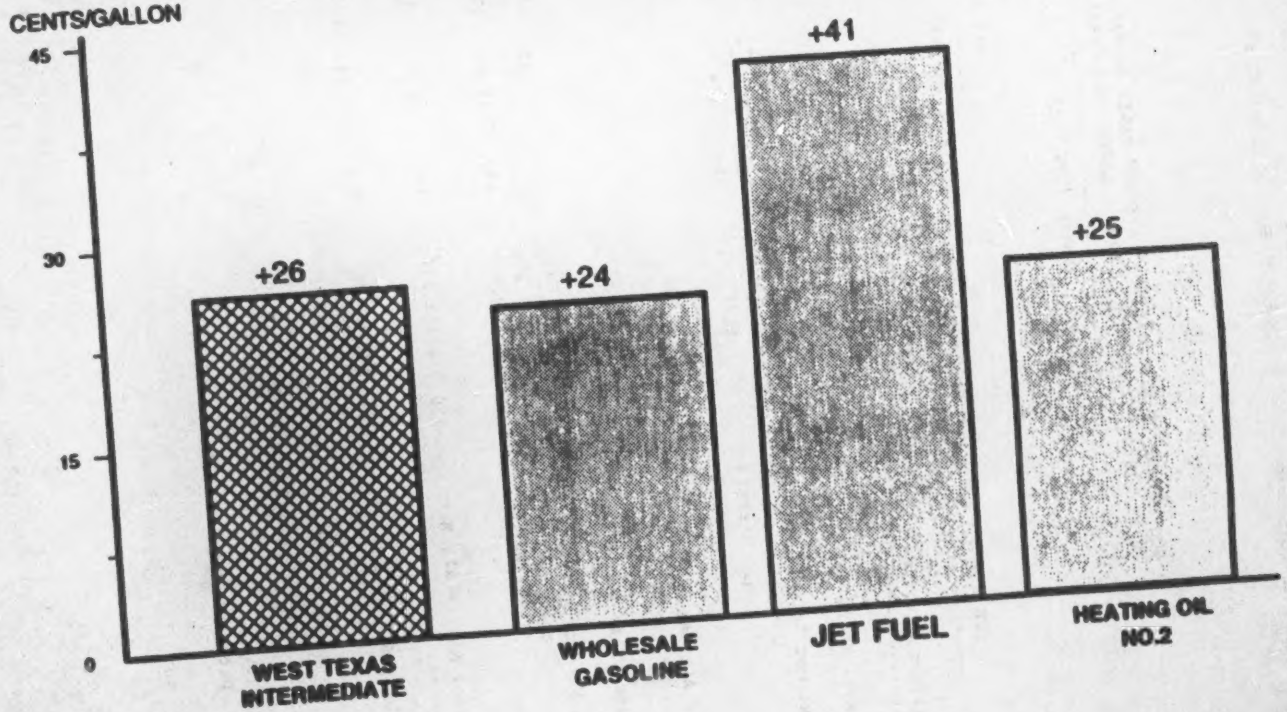
HUB - A/L	# MKTS	# PAX	AVG TRIP	AVG FARE ACTUAL	AVG FARE INDUST	ACTUAL AS % OF INDUST
American Airlines						
Markets Where AA:						
Does Not Compete With WN	82	4,914,210	1,071	215.13	158.25	136
Competes with WN	15	1,827,710	269	43.40	78.80	55
All Markets	97	6,741,920	863	169.51	138.54	122
Delta Airlines:						
Markets Where DL:						
Does Not Compete With WN	82	2,431,370	1,028	190.88	153.30	125
Competes with WN	12	988,210	415	68.01	79.91	85
All Markets	94	3,419,580	823	149.85	134.27	112
Southwest Air. - All Mkts	30	4,423,270	291	51.30	83.94	61
TOTAL DALLAS	791	17,158,260	723	132.96	124.54	107

Rebuttal to AA-T-1, CO-T-1 and DL-T-1.

SOURCE: Database Products, Inc., YE 3Q89.

Exhibit H

CHANGES IN SPOT PRICES
CRUDE OIL (WTI) AND PETROLEUM PRODUCTS
1st WEEK OF AUG/90 VS 2nd WEEK OF NOV/90



SOURCE: Department of Energy

BEFORE
THE SUBCOMMITTEE ON AVIATION
OF THE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
OF THE U.S. HOUSE OF REPRESENTATIVES

HEARINGS ON
THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY
AND
THE ADEQUACY OF COMPETITION

TESTIMONY OF
PAUL STEPHEN DEMPSEY
FEBRUARY 5, 1991

Mr. Chairman, distinguished Congressmen, my name is Paul Stephen Dempsey. I am Professor of Law and Director of the Transportation Law Program at the University of Denver, a position I have held for more than a decade.

Several years have elapsed since I last had the opportunity to testify before the House Committee on Public Works and Transportation. I am deeply honored to have been invited to testify before you today on the critical issues facing the air transport industry.

I. THE DISINTEGRATION OF THE U.S. AIRLINE INDUSTRY

This is a period of crisis for the airline industry, one that was not entirely unforeseen, but one which was nonetheless, unfortunate and avoidable. The American airline industry is rapidly disintegrating. Five major airlines are now in some advanced stage of liquidation, desperately selling off operating assets to raise enough cash to stay aloft. Three of them have stumbled into bankruptcy, and one of those has died.

Before deregulation, most sober minded industry analysts warned that after a binge of destructive competition, only a handful of airlines would survive. These warnings were dismissed by laissez faire economists and deregulation zealots, who insisted that if we amputated the dead hand of regulation and sewed on Adam Smith's invisible hand, we would enjoy nearly textbook levels of perfect competition.

Deregulation was supposed to produce lots of new airlines. We were told that barriers to entry and economies of scale were insignificant. But most of the new entrants couldn't survive. Many, like People Express, were consumed in mergers and acquisitions or, like Air Florida and 150 other airlines, fell into the abyss of bankruptcy. Although they sent ticket prices spiraling downward, new entrants never accounted for more than about 5% of the passenger market. Today, new entry is highly unlikely.

The magnitude of the crisis with which the airlines are now confronted is unprecedented in the history of commercial aviation. Two weeks ago, after a prolonged illness, Eastern Air Lines was laid to rest. The tragedy that was Eastern's could be dismissed as an aberration were it not for the fact that four other major U.S. airlines -- Continental, Pan Am, TWA and Midway -- are liquidating major operating assets to stay aloft. They are gnawing off their arms and legs, not spinning off hotels and rent-a-car companies. Pan Am and Continental have also stumbled into bankruptcy, Continental for the second time (some call it Chapter 22 bankruptcy). More will likely follow. Take a closer look at the disintegrating airlines:

A year after closing its Kansas City hub, Eastern entered bankruptcy and sold its Washington-New York-Boston shuttle as well as the Latin American routes it picked up a few years earlier at Braniff's fire sale. After running out of cash, it ceased operations in January.

Pan Am is selling its trans-Atlantic routes to London and may also sell its Washington-New York-Boston shuttle. The 1980s was a decade of dismemberment for anemic Pan Am, during which it sold off its trans-Pacific routes, its hotel chain, and the Manhattan skyscraper which still bears its name. The 1990s look even worse for this once proud pioneer of international aviation, now in bankruptcy.

TWA is selling off international routes, gates and landing slots at Chicago and Washington, D.C., filling owner Carl Icahn's war chest for other corporate raids.

Midway is selling off the Philadelphia gates it picked up at Eastern's fire sale.

In bankruptcy for the second time in a decade, Continental is selling off its lucrative Seattle-Tokyo route.

The airline industry suffered recessions and sharply increased fuel costs before deregulation. Fuel prices shot up 300% in the 1970s, after the Arab oil embargo of 1973, and there was recession in the early 1970s as well.[1] But never before have major airlines collapsed.

The crisis has prompted the U.S. Department of Transportation [DOT] to propose foreign ownership as a panacea to save the disintegrating U.S. airline industry from its failed experiment in market Darwinism. Secretary of Transportation Samuel Skinner has proclaimed the deregulation experiment a profound success, declaring the deregulation debate over. He ought also to suggest that Congress just write the half trillion dollar check to bail out the savings and loan industry, and not ask why -- not question whether imprudent governmental policy contributed to the catastrophe. In fact, the cause was principally the same in both industries -- deregulation is the illness, and Congress must find a cure.

---

[1] P. DEMPSEY, FLYING BLIND: THE FAILURE OF AIRLINE DEREGULATION (1990).

All the world's airlines are paying the sharply higher fuel prices inspired by the Persian Gulf crisis, and all are suffering from the early pangs of global recession. But only America's are in bankruptcy, only America's have died, only America's are selling off operating assets -- despite the fact that international aviation fuel costs more than domestic fuel.

Why is the U.S. airline industry disintegrating? Unlike their foreign cousins, America's airlines have been ravaged by more than a decade of deregulation. The fuel crisis and recession only accelerate the inevitable march toward increased concentration.

The airline industry is today more highly concentrated than at any time in its history. The guru of deregulation, former CAB Chairman Alfred Kahn, blames the Department of Transportation for failing to enforce the antitrust laws. DOT never met a merger it didn't like, and approved all 21 submitted to it. But whether our government approves airline mergers (as it did during the 1980s), or insists on liquidations (as it likely will in the 1990s), the inexorable result of deregulation is unprecedented concentration.

How then, does the fuel crisis and recession hasten the trend? Three reasons.

First, the operating losses engendered by deregulation created huge debt. During deregulation's first eight years, the industry lost more than $7 billion in interest payments and operating expenses -- until now, the worst financial period in the industry's history. The industry became an economic basket case, prompting the rash of mergers in the mid-1980s.

Deregulation also freed corporate raiders, like Frank Lorenzo (at Continental and Eastern) and Carl Icahn (at TWA), to loot airlines, leaving them with suffocating debt. TWA owes $3.2 billion in long term debt, lease obligations and unfunded pension liability. Pan Am has $3 billion in such obligations.2 Continental suffers from about $2.2 billion in debt.3 Eastern's collapse could expose parent Continental to an additional billion dollars of liability for Eastern's unfunded pension obligations and the transfer of assets into the Texas Air empire at less than fair market value. Interest payments recently exceeded 8% of operating expenses at both TWA and Eastern -- the highest in the industry. It is no wonder the anemic airlines are cannibalizing assets to stave off extinction.

Representative Byron Dorgan aptly noted, "I'm not so alarmed if they load up a lipstick company with debt and it fails. But if you do that to an airline, it's a real blow to the public interest." Indeed it is. A collapsing infrastructure industry sends shock waves throughout the economy. The Department of Transportation has long held jurisdiction to investigate the "fitness" of airlines plagued with debt. Here, like with respect to so many of its other statutory responsibilities, DOT has shown no enthusiasm for protecting the public interest.

Second, with inadequate resources to buy new planes, the U.S. fleet degenerated into the oldest in the developed world. Older generation aircraft gulp more fuel. TWA and Pan Am fly the oldest jets in our geriatric U.S. fleet.

Third, deregulation also produced the fuel guzzling hub-and-spoke phenomenon -- the dominant megatrend on the deregulation landscape. Airlines prefer them because they can charge passengers 27% more (by U.S. General Accounting Office [GAO] estimates) at the concentrated hub airports. Today, a single airline controls more than 60% of the passengers at about 18 major airports; none were so dominated before deregulation.

---

2 Smith, Pan Am Stock Soars As Icahn Makes New Bid, Wall St. J., Dec. 18, 1990, at A4.
3 Mahoney, Financial Fig Still Dogs Continental Airlines, Denver Post, Aug. 12, 1990, at G-1.

Hubbing requires that airlines fly passengers more miles in smaller aircraft with more takeoffs and landings. Funnelling passengers through constipated hub-and-choke bottlenecks not only squanders billions of dollars of business traveler time and productivity, it burns fuel wastefully.

Of course, a few gargantuan airlines will survive. The healthiest three, United, American and Delta, already control nearly half the market. All three are on a buying binge, gobbling up the dismembered parts of the disintegrating airlines.

II. SURVIVAL CHARACTERISTICS

I have identified nine survival characteristics for airlines. They are neither listed in order of importance, nor are they of equal value. But generally speaking, the more of them an airline possesses, the better its chances for survival:

1. MULTIPLE HUBS, STRATEGICALLY LOCATED -- Before deregulation, while Atlanta (for Delta) and Pittsburgh (for Allegheny, now USAir), were moderately concentrated, no airline dominated more than 50% of the market (measured by gates, passengers, or takeoffs and landings) at any major airport in the nation. Today, dominant airlines control more than 60% of the market (sometimes more than 90%) at about 18 major airports.

Strategically located hubs are designated to allow the carriers to blanket the nation with service. For example, United has hubs in Chicago, Denver, San Francisco, and Washington, D.C. (Dulles). American Airlines has its traditional hubs at Chicago and Dallas/Ft. Worth, but has expanded aggressively by establishing hubs at San Jose, Nashville, Raleigh/Durham and San Juan. Delta has hubs at Atlanta, Cincinnati, Salt Lake City.

In contrast, ailing airlines like TWA have a domestic hub only at St. Louis (and an international hub at New York-Kennedy) and Pan Am dominates no domestic airport. Among the disintegrating airlines, only Continental has multiple strategically located hubs -- at Houston, Denver, Cleveland and Newark (the latter it acquired from People Express on its death bed).

Moreover, consumption of airport infrastructure can translate into higher yields. Airlines with more gates, takeoff and landing slots (at capacity constrained airports), and/or code sharing agreements charge significantly higher prices than those without, according to the GAO.

2. FREQUENT FLYER PROGRAMS -- The widespread service permitted by multiple hubs allows airlines to enjoy economies of density, and better market their product to the most lucrative customer, the business traveler. They offer to fill all his business needs, while luring him with rewards of free travel to exotic destinations. In essence, they encourage business fraud.

Suppose, for example, a seller of copying paper offered to sell a business executive paper at a price 25% higher than his competitors, but promised him two free first class airline tickets to Hawaii if he bought paper from them all year long. Wouldn't the business executive be defrauding his company if he purchased the higher priced paper? Yet that is precisely the type of inducement that airlines offer business travelers addicted to their frequent flyer programs. Once addicted, many business travelers select (and bill their companies for) the higher priced flight on the airline satiating their desire for free travel.

3. COMPUTER RESERVATIONS SYSTEMS -- According to the GAO, an airline which owns its own computer reservations system stands between a 13-18% better chance of selling its product through its system than does a competitor. American Airlines pioneered them, with Sabre. United owns Apollo. Continental owns System One, which it took from Eastern for a good deal less than its fair market value. TWA, Northwest and Delta share the combination of PARS and DATAS II.

Computer reservations systems also have created a sophisticated and expedient means of exchanging pricing proposals, and have facilitated implicit price fixing. They also produce extraordinary profits for their owners, far beyond the rents which could be exacted in a fully competitive market.

4. SOPHISTICATED YIELD MANAGEMENT -- Airlines have learned that by watching passenger demand carefully, they can shrewdly manipulate the number of seats for which restricted discounts are offered on an hourly basis, and fill seats with passengers paying the maximum price. That explains the phenomenon of tens of thousands (40,000 to 60,000) of rate changes each day.

5. FUEL EFFICIENT FLEET OF STANDARDIZED AIRCRAFT -- Merged airlines have been forced to deal with the problems of consolidating huge fleets of aircraft of inconsistent types and several manufacturers, which increased the cost of maintenance and require multiple inventories of spare parts. Continental, which flies the fleets of former carriers like Texas International, New York Air, People Express and Frontier, experiences this problem. In contrast, airlines which grow from within (such as, for the post part, American) save maintenance cost and aircraft downtime by incrementally growing with relatively standardized fleets.

Incidentally, the largest airlines now control the order books at the major aircraft manufacturers. Both American and United are taking delivery of new jets every week (and will through the middle of this decade), while the collapsing airlines do not. As noted above, newer generation aircraft are relatively fuel efficient.

6. LOW DEBT (CONSERVATIVE GROWTH) -- The enormous debt assumed by Pan Am and Eastern (to shore up declining revenues) and Continental and TWA (to pay off exorbitant debt put on by corporate raiders) appears to be dragging these airlines down a black hole.

Unfortunately, low debt has subjected some airlines to leveraged buy outs. Low debt suggests there are lots of assets owned which can be sold to pay off the debt assumed during the acquisition. For example, Northwest had one of the lowest percentage of aircraft leased (4%) in the industry prior to its leveraged buy-out.4 In order to thwart potential LBOs, some airlines have sold aircraft and leased them back, a strategy which reduces the inventory of aircraft which could finance an LBO, but nonetheless increases the long-term costs of doing business, whether the debt shows up on the books of the airline or not.

7. LOW WAGES/FLEXIBLE WORK RULES -- Some airlines have broken unions and thereby reduced costs. Continental and TWA are prime examples. Although Continental has lower labor costs than any other major airline, not even that has kept it out of bankruptcy. Labor acrimony, perhaps enhanced by the tactics of its former chairman, Frank Lorenzo, have cost it dearly.

The airline industry is a service industry. Happy employees can give passengers a lovely trip, and lure them back for another, and another. Angry, embittered employees can do the opposite.

Other airlines have convinced unions to settle for two-tier wage rates, with the "B" scale at entry grade. American, United, and Delta are examples. More than half of the present pilot and flight attendant employees at American, for example, are on the "B" scale. Some of the flight attendants at the two-tier airlines, earning about $1,100 or $1,200 a month, qualify for food stamps in domiciles like New York.

But low wages do not guarantee survival. People Express collapsed despite rock bottom wages. Continental and Midway, also with relatively low wages, are struggling to stay alive in the contemporary environment. As a percentage of operating expenses, Delta has the highest labor costs of any major airline. Yet Delta has thrived under deregulation, and most analysts predict it to be one of the few surviving airlines.

8. SUPERIOR SERVICE -- Airline service has degenerated universally under deregulation, so consumers have been taught not to expect much. Consumer

---

4 Aviation Daily, November 6, 1986.

polls reveal they rate foreign airlines higher than our domestic ones. It is no wonder. When USAir consumed Piedmont, its loyal customers were most concerned with the issue of whether USAir would continue Piedmont's practice of giving passengers the full can of Coke, rather than just a cup. That one example reflects how far consumer expectations have fallen.

Let me pose an analogy. Before deregulation, we enjoyed chicken fried steak. Now we eat raw ground horse meat. Consumers save billions of dollars eating horse meat, but it just doesn't taste the same. Sorry, and I'm not at all willing to concede the alleged billions of dollars of savings.

The point is, today, it doesn't take a lot of service to stand out as being better. Consumers can be, and too often are, turned off by late arrivals and departures, dirty planes, inedible food, and embittered employees. The three largest airlines -- Delta, United and American -- typically are rated higher than other domestic airlines in terms of service.

9. INTERNATIONAL ROUTES -- The global air transport market is growing, and many international markets are quite lucrative. Although traffic is temporarily down on the North Atlantic, airlines which serve the North Pacific market enjoy the most attractive yields. Both Northwest and United earn a disproportionate share of their total income from international markets. Between 1987 and 1989, Northwest earned between 68% and 91% of its total operating profit from international markets, while United earned between 24% and 34%.

III. CONCENTRATION IN THE TRANSPORTATION INDUSTRY

Collapsing airlines means more concentration. Already, the eight largest airlines account for more than 90% of the domestic market (up from 80% prior to deregulation). Sadly, additional concentration will send ticket prices soaring into the ionosphere.

The Brookings Institution alleges that consumers save $6 billion a year because of airline deregulation. Not so. Fuel adjusted real air fares fell at a significantly faster rate during the decade before deregulation than in the decade after it. Except for a brief spate of sharply lower fares in the 1977-79 period, post-deregulation fuel and inflation adjusted fares fell at a 30% slower rate per mile than in the pre-deregulation period. The Brookings studies wholly ignore the pre-deregulation trend of falling ticket prices (which for four decades, was driven by technological improvements) and attribute all price savings since promulgation of the Airline Deregulation Act of 1978 to its favorite ideology, deregulation.

Paradoxically, while deregulation was supposed to produce more competition, lower prices and better service, it has instead produced more concentration, higher prices and miserable service. Every major prediction made by the textbook economists has proven wrong.

The airline story could itself be considered a curious aberration if the concentration epidemic was not also plaguing every other mode of transport. But under deregulation, the number of major railroads dwindled from twelve to seven, with no significant new entry. Two thirds of the general freight trucking companies collapsed, with no significant new entry. And with the merger of Greyhound and Trailways, the bus duopoly became a monopoly, and is now in bankruptcy; here too, there has been no significant new entry.

IV. FOREIGN OWNERSHIP

Now that deregulation has failed to produce the near perfect model of textbook competition the laissez faire economists predicted, the deregulationists are proposing to sell our domestic industry off to foreign airlines. Already Northwest, Delta, Continental, America West and Hawaiian Airlines have significant foreign equity. DOT has suggested that, insofar as foreign ownership is concerned, the sky is the limit.

In 1989, Secretary of Transportation Samuel Skinner expressed legitimate concern over the Checchi group acquisition of Northwest Airlines, not only because the LBO would increase Northwest's debt fourfold, but also because the $400 million equity participation by KLM Royal Dutch Airlines would give it about 57% of total equity.5 Secretary Skinner appeared to interpret section 101(16) of the Federal Aviation Act to limit foreign equity to 25%. As Skinner said,

> While KLM's voting share technically fell within the statute's numerical limits [which requires that the airline's President and two-thirds of its Board and other managing officers be U.S. citizens, and that not less than 75% of voting interest be owned and controlled by U.S. citizens], we concluded that KLM's ownership of 57 percent of NWA Inc.'s total equity, together with the existence of other links between the carriers and KLM's position as a competitor, could create the potential for the exercise of influence and control over the carrier's decisions. This would be inconsistent with the law.6

Remarkably, that which Secretary Skinner then declared would be, in his words, "inconsistent with the law", he now proclaims to be well within the law.

The statute has not been amended since Secretary Skinner found that KLM's gargantuan ownership was inconsistent with the law. The U.S. Department of Transportation continues to hold jurisdiction under section 401 of the Federal Aviation Act to scrutinize the fitness of airlines (which includes safety and compliance fitness), and under section 101(16) to review foreign ownership (which cannot exceed 25% of the U.S. flag carrier). Under present law, foreign ownership is limited to 25% of the voting stock of U.S. airlines, and no foreign airline can ply the domestic trade.

---

5 Statement of Samuel Skinner Before the Aviation Subcomm. of the House Comm. on Public Works and Transportation (Oct. 4, 1989), at 4. Had the management/pilot deal for United not fallen through, British Airways was prepared to supply $570 million, or 78% of the total $965 million equity. Valente & McGinley, UAL Machinists Refuse to Back Buy-Out Plan, Wall St. J., Oct. 5, 1989, at A6.

6 Statement of Skinner, supra at 4-5. In September 1989, Skinner jawboned Checchi and Northwest into agreeing, inter alia, to limit KLM's voting stock to 25%, and to limit KLM's representation on Northwest's Board of Directors to "matters relevant to KLM's pecuniary interest, recusing himself or herself when the board is dealing with certain matters, such as bilateral negotiations and competitive issues." Id. at 6.

In a radical departure from precedent and a tortuous interpretation of law, DOT announced recently that it will allow foreign equity ownership of up to 50%. It has even proposed to put the exchange of cabotage rights (the opportunity for foreign airlines to serve domestic routes) on the table in forthcoming negotiations with the government of Canada, despite the legislative prohibition. Actually, foreign airlines don't need cabotage rights if they can buy access to the U.S. market.

Foreign alliances with U.S. airlines began in the 1980s with shared frequent flyer programs, then entered computer reservations systems, and now have turned to outright equity ownership. The two dominant European computer reservations systems have the following alliances:

EUROPEAN COMPUTER RESERVATIONS SYSTEMS PARTNERS

Covia	Amadeus
United	Texas Air
British Airways	Air France
KLM	Lufthansa
Swissair	Iberia
Alitalia	SAS

International airline alliances have been stimulated by the prospect for liberalizing European transport in 1992.[7] Having witnessed the intense shakeout deregulation produced in America, foreign management believes that the liberalization of competitive rules will result in extreme concentration. The conventional wisdom is that, when the dust settles from U.S. deregulation and international aviation liberalization, only a handful of global megacarriers will dominate air transport. Several industry experts predict that the world's air transport system will eventually be dominated by just eight to ten global megacarriers.

---

[7] Dempsey, Aerial Dogfights Over Europe: The Liberalization of EEC Air Transport, 53 J. AIR L. & COM. 615 (1988); P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION 93-108, 241-56 (1987).

Wanting to be among the survivors motivated the contemporary surge in international combinations and alliances. Moreover, with the Europe's aviation infrastructure even more saturated than America's, opportunities for growth are largely limited to acquiring or affiliating with existing airlines.

Foreign airlines are deeply interested in penetrating the U.S. passenger market -- a market larger than that of the rest of the world combined. In the last few years, KLM bought a huge piece of Northwest, SAS purchased a chunk of Continental, Singapore Airlines and Swissair each acquired a slice of Delta, and British Airways (which gobbled up British Caledonian and took a sizeable bite of Sabena) sought a share of United Airlines. The following chart depicts the substantial foreign airline interests in U.S. flag carriers:

FOREIGN AIRLINE OWNERSHIP OF U.S. AIRLINES

Foreign Airline	Percentage Ownership	U.S. Airline
SAS	18.4%	Continental
Swissair	5%	Delta
Singapore Airlines	5%	Delta
Ansett Airlines	20%	America West
Japan Air Lines	20%	Hawaiian Airlines
KLM	49%	Northwest
British Air	15%*	United

* proposed; later withdrawn

The equity interests by Scandinavian Airline System [SAS] in Continental Airline Holdings was inspired by the American carriers' need for a substantial infusion of new capital. From SAS's perspective, the Texas Air alliance gave it new feed into its transatlantic routes; SAS moved its international hub from New York

Kennedy Airport to Newark, where Texas Air's Continental and Eastern could provide domestic feed.8 (However, SAS may have over-extended itself, and is retrenching with lay-offs). Swissair's and Singapore Airlines' interest in Delta appears to have been inspired by different reasons -- the desire of Delta to have a friendly partners poised to fend off LBOs.

But most are motivated by foreign airlines' interests in creating operating and market alliances. Thus, they invest "dumb equity", accepting sub-optimal returns because they anticipate synergistic revenue on the passenger feed U.S. airlines promise them, and the diminution of competition thereby created.

Not only are foreign airlines affiliating with U.S. carriers. Other international aviation alliances are emerging, including British Airway's acquisition of British Caledonian, the British Airways/KLM stake in Belgium's Sabena Airlines, the SAS interest in Aerolinas Argentinas, and the purchase of 35% of Air New Zealand by a consortium consisting of Qantas, Japan Air Lines and American Airlines.9 KLM bought a piece of Air UK. All Nippon Airways (ANA) and Swissair purchased an interest in Austrian Airlines.

Foreign ownership raises serious anti-competitive concerns. Many international markets are already among the highest priced, fastest growing, most lucrative and least competitive. For example, United and Northwest both earn a disproportionate share of their profits from the trans-Pacific market. How vigorous a competitor would they be if Japan Air Lines (or for that matter, Korean Air Lines, or Cathay Pacific) owned a significant chunk of either?

Already, KLM owns half the equity of Northwest Airlines, an ownership interest now blessed with the U.S. Department of Transportation' good

---

8 Repeating Mistakes, Journal of Commerce, Aug. 30, 1989, at 8A.
9 Going Steady, ECONOMIST (July 22, 1989), at 39.

housekeeping seal of approval. Both KLM and Northwest serve the U.S.-Europe market. How vigorous a competitor can we expect Northwest to be with its owner?

Further, most foreign airlines are owned, in whole or part, by their governments. Monopoly is not the antithesis of competition; socialism is. A government owned or subsidized airline does not have to make a profit to stay alive, and therefore lacks a proper competitive discipline. Their presence in a "free market" creates an unlevel playing field. Government treasuries have financial resources beyond the dreams of privately owned companies. Foreign governments can subsidize losses or underwrite the capital requirements necessary to develop monopoly positions.

At the outset of deregulation, some predicted that ultimately only a handful of airlines would survive, and that they would be nationalized as wards of the state. Never did they dream that the few surviving airlines would be wards of foreign governments.

Today, about 8% of Northwest is owned by the government of the Netherlands. About 8% of Continental and Eastern are owned by the Scandanavian governments. We have now embarked upon a regime of partial nationalization, not by our government, but by foreign governments.

Foreign ownership restrictions have long existed for many of our essential infrastructure industries -- airlines, intercoastal and inland shipping, telecommunications, broadcasting, electric power production, and nuclear energy. These restrictions were added to our law not because of blind xenophobia, but because of legitimate national security considerations.

Aviation is essential to national security. As operation Desert Shield confirms, the nation depends on the aircraft of our domestic airlines committed to the Civil Reserve Aviation Fleet [CRAF] as the essential logistical means to ferry troops and supplies to distant battlefields. We need the CRAF fleet for airlift capacity in time of war. Foreign ownership may jeopardize access to it. The Air Force simply doesn't have enough C-5As to do the job.

On August 2, 1990, Iraq invaded Kuwait. Two weeks later, the CRAF fleet was activated -- the first time since its creation in 1951. Calling up the CRAF fleet was essential in order to meet the demands of the most massive airlift since the Berlin Airlift in 1948. During the first two months of activation, CRAF planes flew more than 500 missions, carried 66,000 passengers (mostly soldiers) and 22,000 tons of cargo. The CRAF fleet has ferried 60% of the troops and 23% of the cargo to the Persian Gulf region.

Similarly, we maintain a federally subsidized U.S.-flag fleet of ocean carriers because of the lesson we learned in World War I -- when we looked around for essential ships to ferry troops and supplies across the Atlantic, there were nearly none. Not that long ago, the federal government bailed out a collapsing Conrail and Lockheed, in part, because of their importance to national security. Transportation is essential to our national defense.

Of course, we could commandeer the aircraft of foreign airlines if we needed them -- seize the property of foreign companies as other nations have done to American firms. But acquisition of capacity is not the only problem.

Those who argue for foreign ownership of domestic airlines forget that most of the technological breakthroughs of aviation were inspired by its military applications -- its proficiency in delivering troops and bombs. Imagine a world where we had never prohibited foreign ownership or foreign airline competition. How many Pearl Harbors would we have suffered if the dominant domestic airlines in 1940 had been Lufthansa and Japan Air Lines?

Although we fought wars with Britain in two centuries, British Airways doesn't look like much of a national security threat these days. But our alliances are constantly shifting, so that an Aeroflot looks more or less threatening depending upon the point in history at which you ask the question. Today, would we want Donald Trump to sell the Trump shuttle to Iraqi Airways?

In 1974, the Shah of Iran proposed to buy Pan American World Airways. Had Secretary of Transportation Skinner been calling the shots then, he might well have allowed it. After all, Iran was our closest ally in that part of the world.

We all know the tragic events which transpired in Iran after the fall of the Shah. If the foreign ownership rules adopted by DOT in 1991 had been in effect in 1974, would we find Pan Am's 747s parked on military airfields in Iran next to Iraqi jet fighters?

We need to keep our essential infrastructure industries out of foreign hands so that we don't wake up one day in the midst of a global crisis wondering why we were so short sighted as to allow them to be crippled by our adversaries. We don't want foreign owners sabotaging, disrupting or delaying the free movement of commerce, or communications, or electric power, or indeed, putting their grubby hands on nuclear fuel rods. We need a healthy domestic infrastructure capable of serving the nation loyally in times of crisis.

Moreover, foreign ownership jeopardizes the integrity of bilateral air transport negotiations between the United States and foreign governments. International routes are traded by nations on a bilateral basis, usually with candid input from their carriers.10 Multiple allegiances may well jeopardize the integrity of that process.

V. CONCLUSIONS

Foreign ownership restrictions didn't cause the disintegration of our domestic airline industry. Neither did the current fuel crisis.

---

10 See generally, P. DEMPSEY, LAW & FOREIGN POLICY IN INTERNATIONAL AVIATION (1987).

Look around the world. No foreign airline is in as sorry shape as ours -- none are liquidating operating assets, none are in bankruptcy, and none have died -- despite the fact that international aviation fuel costs more than domestic fuel, and the entire world is feeling the pangs of recession.

Surely, we need to alleviate the economic crisis plaguing the airline industry and threatening healthy competition. To do that, we best get on tackling its true cause -- deregulation -- rather than hastily grasping for radical alternatives which might endanger our national security.

There are more than two temperatures at which to cook a pot of stew. In the 1970s, the competitive dial was set on LOW. The stew wasn't warm enough, so Congress turned the dial all the way up to HIGH by promulgating the Airline Deregulation Act of 1978. The competitive bubbles began to boil, causing stew to splatter over the side of the pot. The aroma was sweet for a short while, until it turned foul with smoke. Before the stew burns a charcoal black, Congress should turn the dial down to MEDIUM, so that we can have stew the public can eat.

The public owns the trillion dollar airport and airway infrastructure. Common sense suggests that it ought to have some say in how the airlines use that public system. Consider that all the stock of all the airlines could be purchased on Wall Street for less than $15 billion, or a mere 1.5% the value of the public investment.

Unlike the highways, where people have direct access in their privately owned automobiles, the only access for the great majority of citizens to the airport and airway system they own is via the commercial airlines. Yet the destinations, the terms, conditions and prices of services are all dictated by private monopolists and oligopolists, with no input from the public which owns 98.5% of the system.

Yet deregulation gave away the public system to private monopolists. It replaced the U.S. Civil Aeronautics Board, which protected the public interest, with the chief executive officers of a handful of airlines, who treat the public system as their private Monopoly board, buying and selling properties while charging the public exorbitant rents. They are allowed to turn a profit by selling assets owned by the nation -- landing slots and international routes. Deregulation transformed the air transport system from a public utility into segmented and shared regional and city-pair monopolies, and a national oligopoly.

It would be the equivalent of deregulating the trucking industry, and giving the Interstate Highways to the trucking companies -- letting them set the rates and service conditions of public access. And then, allowing the trucking companies to sell these monopoly rights to the Dutch government.

The tyranny of monopoly gave birth to economic and antitrust regulation in the 19th Century. (Congress regulated the monopoly railroads in 1887, and passed the Sherman Antitrust Act just three years later). A nation which fails to learn from its history is doomed to repeat it.

The Wall Street Journal asked Americans to identify the industries in which they have most, or least, confidence. The largest number by far, 43%, said they had no confidence in the airline industry. The disapproval rating for the industries which followed -- insurance (27%), banking (23%), oil and gas (22%), and stockbrokers (22%) -- was not nearly as high as that for airlines.

Note the common denominator of each of these five industries. Insurance has never been regulated by the federal government, and airlines, banks, oil and gas companies and securities have all experienced significant deregulation during the last decade.

Before deregulation, our transportation system was universally acclaimed to be the world's finest. But since then, the deterioration in our transportation infrastructure, public and private, would embarrass a third world nation. The potholes we dodge on the highways and the aging jets in which we fly are symptoms of a malignant illness.

The failure of deregulation disproves the implicit thesis of the theology of laissez faire -- that unconstrained human greed will produce a better society. It is time for a spoonful of regulatory medicine, while there is still some modicum of competition to preserve. It is time to roll back deregulation, not to the strict regime of the early 1970s, but to an enlightened regime of responsible government oversight. It is time for regulatory reform.

The New York Times

Founded in 1851

THE NEW YORK TIMES, SATURDAY, JANUARY 26, 1991 19

The Sky Ought To Be the Limit

By Paul Stephen Dempsey

DENVER

After a decade of deregulation, the U.S. airline industry is disintegrating. In the 1980's, it suffered more than 150 bankruptcies and 50 mergers. Of the handful of surviving airlines, five are liquidating major assets and three of those have fallen into bankruptcy, including Pan Am this month. Last week, Eastern Airlines died after its prolonged illness.

Paradoxically, while deregulation was supposed to produce more competition, it resulted in unprecedented concentration. Like savings and loans, airlines are reeling from the anarchy created by a regime of laissez faire. This week, the crisis prompted the Department of Transportation to embrace foreign ownership as a panacea to save the collapsing airline industry from its experiment with market Darwinism.

Under present law, foreign ownership is limited to 25 percent of the voting stock of U.S. airlines, and no foreign airline can ply the domestic trade. In a radical departure from precedent and a tortuous interpretation of law, the Department proposes to allow foreign ownership of up to 50 percent of equity. Congress should just say no.

Foreign ownership raises serious anticompetitive concerns. The international markets are already among the highest priced, fastest growing, most lucrative and least competitive. For example, KLM is being allowed to retain more than half of Northwest. Both airlines serve the U.S.-Amsterdam market. How vigorously is Northwest willing to compete with its owner? And how competitive will aviation be if the world's air transport system is dominated by 8 to 10 global megacarriers?

Further, most foreign airlines are owned, in whole or part, by their governments. Monopoly is not the antithesis of competition; socialism is. A government-owned or -subsidized airline does not have to make a profit to stay alive, and therefore lacks a proper competitive discipline. Their presence in a "free market" creates an unlevel playing field.

Foreign ownership restrictions have long existed for many of our essential infrastructure industries — airlines, intercoastal and inland shipping, telecommunications, broadcasting, electric power production and nuclear energy. These restrictions were added to our law, not because of blind xenophobia but because of national security considerations.

Aviation is essential to national security, as Operation Desert Storm confirms. The Air Force simply doesn't have enough C-5A's to do the job. We maintain a federally subsidized U.S.-flag fleet of ocean carriers because of the lesson we learned in World War I — when we looked around for essential ships to ferry troops and supplies across the Atlantic, there were nearly none. Not that long ago, the Government bailed out a collapsing Conrail and Lockheed, in part, because of their importance to national security.

Don't sell U.S. airlines to foreigners.

Of course, we could commandeer the aircraft of foreign airlines if we needed them — seize the property of foreign companies as other nations have done to American firms. But acquisition of capacity is not the only problem. Those who argue for foreign ownership of domestic airlines forget that most of the technological breakthroughs of aviation were inspired by military applications — proficiency in delivering troops and bombs.

Imagine a world where we had never prohibited foreign ownership or foreign airline competition. How many Pearl Harbors would we have suffered if the dominant domestic airlines in 1940 had been Lufthansa and Japan Air Lines? Although we fought wars with Britain in two centuries, British Airways doesn't look like much of a national security threat these days. Neither did Iran Air before the fall of the Shah.

Our alliances are constantly shifting, so that an Aeroflot looks more or less threatening depending upon the point in history at which you ask the question. Today, would we want Donald Trump to sell the Trump Shuttle to Iraqi Airways?

We don't want foreign owners sabotaging, disrupting or delaying commerce, communications or electric power, or indeed putting their grubby hands on nuclear fuel rods. We need a healthy domestic infrastructure capable of serving the nation loyally in times of crisis.

Foreign ownership restrictions didn't cause the disintegration of our domestic airline industry. Neither did the current fuel crisis. No foreign airline is in as sorry shape as our airlines, despite the fact that international aviation fuel costs more than domestic fuel and the entire world is feeling the pangs of recession.

Surely we need to alleviate the economic crisis plaguing the airline industry and threatening healthy competition. To do that, we best get on with tackling its true cause — deregulation — rather than hastily grasp for radical alternatives that might endanger our national security. □

Paul Stephen Dempsey, director of the University of Denver transportation law program, is the author of "Law and Foreign Policy in International Aviation."

The Dangerous Cost of Airline Deregulation

By Paul Stephen Dempsey

THE latest chapter in airline deregulation is a prescription for disaster. Most airlines are saddling themselves with enormous debt and fleet capacity. Watch out if recession rears its ugly head.

Two reasons account for the sudden surge of interest in airline acquisitions. First, after more than 150 bankruptcies and 50 mergers, the industry has become an oligopoly. Eight megacarriers dominate 94 percent of the domestic passenger market. With fortress hubs and shared monopolies, ticket prices are ascending into the heavens. Now that airlines are becoming money machines, they have become targets for leveraged buyouts (LBOs).

Second, the industry's glamor has always attracted men with huge egos. In the old days it was buccaneers like Howard Hughes, Eddie Rickenbacker, and Juan Trippe. These days it is Marvin Davis, Donald Trump, and Peter Ueberroth. Owning an airline is more prestigious than owning an NFL franchise, for there are fewer of them. Owning an airline also means becoming emperor of several fiefdoms, for the fortress hubs have a stranglehold on the cities they serve.

Prior LBOs reveal that raiders leverage airlines to the teeth to pay for acquisitions. In the mid-1980s, Frank Lorenzo gobbled up Eastern, while Carl Icahn grabbed TWA and Ozark. They added millions in indebtedness to these once proud airlines, while stripping them of assets. Before Eastern fell into bankruptcy, it carried $2.5 billion in long-term debt; its debt service was a crushing $575 million a year. TWA carries $2.4 billion in debt and lease obligations, and has a negative net worth of $30 million.

Not only are LBOs burying airlines in debt, new aircraft acquisitions are as well. Media attention has focused on the geriatric jets – the peeling skin and the exploding doors. The fear of flying has prompted airlines to order huge new fleets of aircraft. The conventional wisdom also identifies fleet mass as a key ingredient of survival. So fleets grow.

Adding new jets will reduce the average age of the nation's fleet. That will increase the margin of safety, but it saddles the industry with even more debt.

What's worse, unlike the days before deregulation when airlines actually owned most of their aircraft, today they lease them. For example, American Airlines owns only a third of its 476 aircraft outright. Even solid carriers like Delta have sold large numbers of aircraft only to lease them back. That increases debt, but decreases value. Potential and successful LBOs will accelerate this trend.

Lease obligations usually don't show up on balance sheets as debt, but like accumulated frequent-flyer mileage, they should. When these obligations are included, the industry's debt-to-equity ratio is significantly worse than it was in the mid-1980s, although industry performance has dramatically improved.

Couple a recession with excess capacity and high debt servi. and we will see another round of bankruptcies and mergers.

Whether purchased outright or leased, new aircraft not only impose tremendous debt, they also flood the market with capacity. For example, American Airlines may have a fleet of more than 800 aircraft by the late 1990s. If we learned nothing else from deregulation, we should have learned that excess capacity causes prices to spiral downward, and leaves the airlines afloat in red ink. A soft economy may dissuade the airlines from retiring the geriatric jets.

So now the wild cards – fuel prices, air terrorism, or recession. The former will raise industry costs, as they did in the 1970s and 1980s; the latter two will curtail demand. Few industries are as susceptible to downward turns in the economy as are airlines. Recessions prompt travelers to cancel their vacations and businessmen to tighten their belts. Passenger demand plummets.

Couple a prolonged recession with excess capacity and high debt service, and we will see another round of bankruptcies and mergers like the one in the early 1980s. When the dust settles, the industry will be even more concentrated than it is now. As the economy improves, surviving megacarriers will raise prices more ruthlessly.

Sooner or later, the US government will reregulate the airlines. Better that it jump in sooner rather than later to halt widespread failures in an industry so important to the nation's commerce, communications, and national defense, and to preserve what little competition remains.

There are more important interests than the greed of a small and exclusive club of corporate robber barons. America needs a safe and dependable transportation network, providing decent service at a fair price. Responsible government oversight of this important infrastructure industry is essential to restore its position as a servant of the public interest.

■ *Paul Stephen Dempsey is distinguished visiting professor of law at DePaul University, and director of the transportation law program at the University of Denver College of Law. He is author of "The Social and Economic Consequences of Deregulation."*

Chicago Tribune

Chicago Tribune, Tuesday, December [illegible] Section [illegible]

Air deregulation: Chaos out of order

By Paul Stephen Dempsey
and Theodore P. Harris

Americans should be repulsed by the spectacle of the vultures of United and American (the nation's largest airlines) picking through the bloody carcasses of Eastern, Pan Am and TWA, ripping and tearing at the flesh of these once proud carriers. Some claim that the fuel crisis and looming prospects for recession are to blame. Actually, they only hasten the inevitable consolidation of an industry ravaged by deregulation.

United is devouring Pan Am's most important transatlantic routes, and several of TWA's gates and landing slots. American is feasting on Eastern's Latin American routes, and TWA's routes, gates and landing slots. Midway and near-bankrupt Continental have also put their limbs on the auction block. Like frightened animals caught in steel traps, these airlines, once among the largest and best in the world, are gnawing off their arms and legs, hoping to stave off extinction with a quarterly profit statement or two.

The social Darwinism unleashed by deregulation has created unprecedented concentration in the airline industry. Eight airlines now control more than 90 percent of the domestic passenger market, and only four or five of them are viable.

Deregulation was supposed to produce more competition, not less. As an ideology (more a theology, really) resting on a crumbling foundation of specious assumptions, it achieved only one thing—it created chaos out of order. Not since the Bolshevik Revolution has the discipline of economics embraced an ideology with such zealotry. Unfortunately, laissez-faire ideologues continue to dominate the U.S. Department of Transportation. It is they who have emasculated DOT into ineffectiveness and abdication of the public interest.

Today deregulation advocates tell us that the problem with deregulation is that there is not enough of it. Privatize the airports and allow foreign airlines in, they insist, and we will at last prosper in the land of laissez faire. Never mind that they have been promising us nirvana for a decade from the heavy doses of deregulation they have already shoved down our throats.

One is reminded of the headlines on the front page of the grocery tabloid, in which a shapely 22-year-old nymphette claims she lost 80 pounds on a diet of hot fudge sundaes. "Something in the fudge just burns away the calories," she alleges. Alas, our fat won't go away because we don't eat enough hot fudge sundaes. Similarly, the proponents of laissez faire insist deregulation will never give us what we want unless we consume more deregulation.

Before deregulation, most sober-minded industry experts agreed that when all the dust settled, only a handful of gargantuan airlines would remain. Three to five carriers was the best bet.

In contrast, the deregulation ideologues promised that if we amputated the dead hand of regulation and replaced it with Adam Smith's invisible hands, we would enjoy lower prices and better service. No danger of concentration, they alleged, because they saw no economies of scale or barriers to entry. More competition, lower prices, better service—the seductiveness and simplicity of the theory was intoxicating.

But deregulation's intoxicated disciples failed to appreciate the resourcefulness of airline management to evade competition and dominate the airport bottlenecks. The largest airlines have the resources to control the major airports and keep the weaker carriers out—and they always do when push comes to shove. Today, more than 60 percent of the gates, passengers and takeoffs and landings at about 17 major hub airports are dominated by a single airline (there were none so dominated before deregulation). Notwithstanding the fact that the American taxpayer owns the $1 trillion airport and air traffic control system, the CEOs of a handful of huge airlines play a game of Monopoly that cheats the public of its system.

Despite the predictions of the free-market prophets, deregulation produced an unprecedented period of ruinous competition, 150 bankruptcies, 50 mergers, and seems to be headed right where the industry experts thought it would—to a highly concentrated oligopoly, or more precisely, shared monopolies. Along the way, tens of thousands of dedicated airline employees lost their jobs, creditors and investors were stiffed and consumers defrauded. Cities and whole regions saw service deteriorate or disappear. What accounts for this?

First, the industry sells what is in the nature of an instantly perishable commodity. Airline seats must be sold by the moment a scheduled flight pulls back from its gate, or they are lost forever. In contrast, manufactured goods not sold today can be shelved until tomorrow. Second, short-term marginal costs are nil. Adding another human bottom to a scheduled seat costs the airline a few drops of fuel and another bag of peanuts.

Economist Alfred Kahn, the Civil Aeronautics Board chairman who championed deregulation, once said he could discern no difference between grocery stores and airlines. OK, Mr. Kahn, pay attention. Imagine a grocer whose entire inventory has the spoilage properties of unrefrigerated mayonnaise, and all customers must be lined up to come to the store to pick up their groceries at three-hour intervals, and that which is not sold must promptly be carted off to the dump. That is a grocery store with the economic characteristics of an airline.

The social Darwinism unleashed by deregulation has created unprecedented concentration in the airline industry. Eight airlines now control more than 90 percent of the domestic passenger market.

Put these ingredients together and sprinkle in a bit of excess capacity and you have airlines spiraling downward in destructive competition—which, lest we forget, was the reason Congress regulated them in the first place, back in 1938.

Airlines strive to avoid competition any way they can to turn a profit. Fortress hubs, computer reservations systems, shared monopolies—all are vehicles to avoid head-to-head, destructive competition. Discriminatory pricing and service are symptoms of the disease. And consumers will continue to suffer until Congress finds a cure. As we are learning from the lessons of savings-and-loan fiasco, an ounce of responsible preventive government oversight is worth several hundred billion dollars of cure.

Alfred Kahn also blames deregulation's failures on the government's failure to enforce the antitrust laws. Yet whether the government approves airline mergers (as it did in the 1980s) or insists that failing airlines be liquidated (as it will likely do in the 1990s), the number of major airlines is dwindling and competition is disappearing, antitrust or not.

In the 1970s, regulatory reform was well on its way to curing the modest problems that existed in the industry. It is a national tragedy that this good, sensible idea was manipulated into the misery of deregulation.

The pendulum of deregulation has swung too, too far, and must now be reversed. We must return to a sensible course of prudent government oversight. It is time to admit that deregulation is a failure. We'd best get on with developing a responsible alternative before more airlines are thrown into the cannibal's boiling pot.

Paul Stephen Dempsey is director of the Transportation Law Program at the University of Denver. Theodore P. Harris is chairman of Airline Industry Resources Inc., McLean, Va.

TESTIMONY BEFORE THE AVIATION SUBCOMMITTEE OF THE HOUSE PUBLIC WORKS AND TRANSPORTATION COMMITTEE

February 5, 1991

Daniel M. Kasper
Harbridge House, Inc.
Boston, MA 02116
617-267-6410

Formerly Director
International Aviation
U.S. Civil Aeronautics Board

February 5, 1991

Mr. Chairman and Members of the Subcommittee:

I appreciate your invitation to appear before this Subcommittee to discuss the condition of the airline industry and the present and prospective state of competition in that industry.

I am currently the Director of the Transportation Practice at Harbridge House, Inc., an international management consulting firm with headquarters in Boston. Since joining Harbridge House, I have been responsible for a number of projects involving analysis of the airline industry. Clients for these studies have included U.S. airlines, airframe manufacturers, suppliers of a variety of goods and services to the airline industry, the Department of Defense, state Departments of Transportation, and several airport proprietors.. In addition, I have published a number of articles, case studies, and books on various aspects of the airline industry. My analysis of the commuter airline industry was published by The Economist Press in 1987, and a second book, Deregulation and Globalization: Liberalizing Trade in International Air Services, was published by the American Enterprise Institute, as part of its Trade in Services Series.

From 1979 through 1983, I served at the U.S. Civil Aeronautics Board, first as Executive Assistant to CAB Member Elizabeth Bailey and from early 1980 until September of 1983, as Director of the Board's Bureau of International Aviation. Prior to joining the CAB, I specialized in the study of economic regulation and international competition while serving on the faculties of the Harvard University Business School and, before that, the University of Southern California.

My testimony reflects research undertaken for a project sponsored the American Enterprise Institute as well as analyses undertaken in my role as a member of an independent group of aviation experts known as the Think Tank on Multilateral Aviation Liberalization. But I appear today on my own behalf and the views I express have not been reviewed by, nor do they necessarily reflect, the views of Harbridge House or any other organization.

THE INDUSTRY'S FINANCIAL CONDITION

Those interested in good financial news would be well advised to avoid reading the financial reports of major U.S. and foreign air carriers. In a nutshell, those reports show an industry adversely and, in the case of a few airlines, critically impacted by the effects of sharply higher costs — principally fuel — coupled with a significant softening in demand.

More troubling than the significant operating losses is the fact that several major carriers also appear to be suffering negative cash flows; that is, their revenues are insufficient to cover their current cash obligations. While a negative cash flow is never desirable for an airline, temporary periods of negative cash flow pose no threat to financially sound airlines because their strong cash positions, healthy balance sheets, and access to short-terms lines of credit permit such carriers to ride out periodic financial storms. Indeed, some are even able to acquire assets and otherwise strengthen their competitive positions during such periods.

But several major airlines are not as well-positioned to handle the current turbulence. Some have relied upon LBOs, junk bonds or other forms of highly-leveraged debt to build financial structures ill-suited for adverse economic conditions. Others have failed to develop and/or execute viable strategies for competing in a deregulated market place. This is particularly true for carriers that, as a result of poor management or bad luck, have been unable or unwilling to develop sizable, efficient domestic route networks. Still other financially-vulnerable carriers have suffered as a result of a failure to develop and maintain positive labor relations. For these carriers, the prognosis is more guarded. In my estimation, absent an infusion of new equity capital, or a significant decline in fuel prices and a rebound in traffic, several will find it necessary to sell significant assets in order to continue operations. For at least one carrier, even asset sales may not ensure its long-term survival.

Over the short to medium term, three factors hold the key to the financial performance of most major airlines:

- The duration of the war and the perceived terrorist threat to civil aviation which are adversely affecting airline traffic and revenues.

- The length and severity of the recession which also depresses airline demand and revenues.

- The price of jet fuel which, until the hostilities began, was by far the most significant factor behind the entire industry's poor financial performance.

I am well aware of the difficulty in predicting the future performance of airlines even in normal times. The present uncertainties only reinforce my reluctance to make specific forecasts for 1991 and 1992. What does seem reasonably clear is that at least the first half of 1991 is going to be a financial debacle, and barring a quick economic rebound in the second half of the year, most airlines could record sizeable losses for the entire year.

COMPETITION IN THE AIRLINE INDUSTRY

I would now like to turn to the committee's other concern in these hearings — the state of competition in the airline industry. By now this committee is no doubt acutely aware that, as a result of substantial economies of scale and scope attainable in a deregulated aviation marketplace, the structure of the airline industry is today characterized by a relatively small number of large, single carrier air transportation networks which compete with each other in an expanding number of city-pair markets. In the interests of time, I will not offer further elaboration on these points, but I would be happy to provide it to the Committee separately.

But a reduction in the total number of U.S. airlines does not necessarily indicate a reduction in competition. In this regard, it is particularly interesting to note that, despite an increase in concentration at the national level, airline competition has actually increased at the city-pair level since 1978, as shown by the increase in the number of competitors serving individual city-pair markets and the decline in market share experienced by the leading carriers in those markets. Nor do the financial returns experienced by major airlines over the past decade or even the past several years indicate that the industry is insufficiently competitive.

While I am thus not alarmed by the present state of competition, I am also convinced of the wisdom of the famous American maxim that "The price of liberty is eternal vigilance" and I commend the committee for its willingness to consider whether and how competition can be preserved and strengthened. For I continue to believe that Congress was right when in made clear in passing the Airline Deregulation Act of 1978, that competition is the best way to protect consumers and the public interest.

But what realistic options does the Federal government have to alleviate the present financial distress of the industry and enhance competition. If my analysis thus far is correct, there is only a limited amount the Federal government can or should do in an effort to improve the financial condition of individual carriers or the industry as a whole. Nonetheless, some steps could help.

On the cost side, the Administration has already provided fuel price relief by releasing supplies from the Strategic Petroleum Reserve and additional releases could lead to further fuel price declines. But it would be difficult to justify special treatment which benefited airlines but not other users of petroleum products.

Likewise, the Department of Transportation can and should permit operating airlines to sell international routes — so long as the proposed transfers are subject to a careful competitive review. The principal reason for permitting such sales is that the market is more reliable than administrative law judges and civil servants in allocating routes to carriers that will make the most effective use of them. I have appended to my testimony an article which sets out in more detail my reasons for supporting route sales.

In addition, the Department of Transportation can and should permit increased foreign investment in U.S. airlines to the extent it can do so consistent with the Federal Aviation Act. Further, I believe that the Congress should give prompt consideration to revising the Act to significantly increase — or eliminate entirely — the limits on foreign ownership of U.S. airlines and to authorize U.S. negotiators to negotiate increased foreign investments.

I would not support grants of antitrust immunity to permit airlines to discuss schedule reductions or price increases. Such measures would be difficult to justify even in a tightly regulated industry. I believe they would be wholly inappropriate under the present circumstances.

Finally, I do not believe that the Congress or the Department should now attempt to reregulate airline services or rates. Aside from the fact that it would be impossible to do so without substantially impairing efficiency and service, I believe that the far wiser course would be to adopt policies that strengthen competition by, inter alia, permitting the infusion of foreign equity into U.S. airlines. Because of the potential significance of foreign investment, I would like to address the balance of my remarks to that subject.

Foreign Investment in U.S. Airlines

With regard to foreign investment in U.S. airlines, I would emphasize several points.

- Purchases by foreign airlines of equity interests in U.S. airlines are the result of fundamental economic forces at work in the airline industry, forces that are driving that industry towards a more global structure. Over the next decade, airlines are thus likely to become more transnational — both in terms of their operations and their ownership structures. I will not take the Committee's time at this juncture to elaborate on this point, but I would be happy to provide the Committee with several articles that explain these developments in more detail.

- U.S. airlines, consumers and labor are likely to benefit from a regime that liberally permits transborder investments in airlines. Indeed, the potential benefits are so substantial, I am convinced that it would be a major mistake for the United States to maintain the barriers to foreign investment in the airline industry contained in the Federal Aviation Act. These benefits include enhanced competition and the preservation of competitors in domestic airline markets; the latter consideration is particularly applicable to several of the major U.S. carriers now experiencing financial difficulties.

- The existing provisions of the Federal Aviation Act dealing with foreign investment and control are sufficient to protect U.S. airline, consumer, and labor interests until the United States and its major aviation trading partners negotiate a new regime for international air services — including provisions governing transborder investment — to replace the increasingly outdated system of aviation bilaterals. In the meantime, U.S. negotiators have sufficient leverage to ensure, where necessary, that transborder investment is an option also available to U.S. airlines.

- U.S. national security interests are not likely to be impaired by foreign investment in U.S. airlines and can be fully protected without restricting foreign investment.

- A potentially more difficult problem is posed by the possibility that a foreign airline might be able to use investment in order to circumvent U.S. efforts to trade expanded access to the U.S. market in exchange for expanded U.S. carrier access to foreign markets. For this reason, I would favor limiting the expanded investment rights to carriers based in countries that have signed liberal (open skies) agreements with the United States.

- In a similar vein, U.S. officials must seek to assure that transborder investment in the airline industry is a two-way street, one that can be traveled by U.S. airlines investing abroad as well as by foreign airlines investing here. Currently, most of our trading partners have restrictions on foreign investment that are comparable to or slightly less restrictive than our own. To date, however, Congress has not seriously faced the issue of investment rights, but this is an issue that we can no longer afford to ignore.

- Any equity investment by one airline in another should be subjected to careful scrutiny as to its probable impact on competition without regard to whether that investment is made by a domestic or a foreign airline. In the case of investment by a foreign airline, this examination should consider the existence of bilateral restrictions on new entry as well as the availability of slots and gates for competitors at airports in the foreign country. If problems are found in the review process, divestiture of routes, gates, slots, etc., could be imposed as a condition of approval. The authority to review the competitive impact of these investments currently resides in the Antitrust Division of the Department of Justice. But DOT retains authority over limited entry international routes and could exercise its authority either in a certificate renewal proceeding or, possibly, by instituting a proceeding to take away such routes. In the latter case, the Federal Aviation Act might have to be amended to clarify DOT's authority to take routes away from airlines on competitive grounds.

- In examining the issue of foreign investment in U.S. airlines, however, it is important that we not lose sight of the positive competitive benefits that can result from such investments. In its present situation, for example, Continental might well benefit from an infusion of foreign capital and expertise that could help that carrier rebound from Chapter 11, thereby preserve jobs and strengthen competition.

Thank you, Mr. Chairman. I would be happy to answer any questions from the Committee.

BEFORE THE
HOUSE COMMITTEE ON PUBLIC WORKS & TRANSPORTATION
SUBCOMMITTEE ON AVIATION

TESTIMONY
OF
RICHARD MATHIAS
SENIOR VICE PRESIDENT - GOVERNMENT AFFAIRS
PAN AMERICAN WORLD AIRWAYS, INC.
FEBRUARY 5, 1991

Pan Am appreciates the opportunity to appear before the Committee at this darkest hour of the U.S. airline industry. The industry has a number of long term problems, but the greatest long term problem is surviving the short term.

Pan Am's financial problems are well known, but what you must realize about those problems is that they are no longer unique to Pan Am. Because of the Gulf Crisis and war, every U.S. airline is experiencing a severe financial crisis to one extent or another. The real issue before this Committee, the entire Congress and the Administration is what will our air transportation system look like in 1992 and beyond - and that question has to be answered in the next few months.

The Extent Of The Present Crisis

The Air Transport Association and others can better address the current financial position of the U.S. industry as a whole. Two points are worth noting. First, it has never, ever, been worse. Secondly, the majority of U.S. airlines are desperately short of working capital and are experiencing negative cash flows. As Pan Am can testify on the basis of its own experience, once an airline is in this cycle the rapidity of the decline leaves few alternatives other than the disposition of assets, the limitation of operations and, finally, the protection of the Bankruptcy Code.

In December 1990 American, United and Delta - the only three airlines which clearly have the financial wherewithal to weather the current crisis - accounted for approximately 48% of the industry's revenue passenger miles. I believe that it is probable that unless immediate measures are taken to assist the industry, the Big Three's share could increase to two-thirds or more by this time next year and continue to grow rapidly thereafter.

The Causes Of The Crisis

The U.S. airline industry is unfortunately in a position to become the most significant commercial casualty of the war. Air transportation is energy dependent, and the enormous increases in the price of jet fuel gave rise to previously unimaginable losses in the Fourth Quarter of 1990. For Pan Am alone, the fuel price increase resulted in additional expenditures of over $140 million more than normal during the five months of August through December, 1990. Even though there never was any shortage of either crude oil or refined jet fuel, the so-called "free market" has still not returned prices to normal or justifiable levels. For Pan Am, which buys proportionately more fuel at foreign points where fuel prices are higher than in the U.S., our system average price is still 50% higher than it was last July before the Gulf crisis began.

The second principal cause of the industry's financial crisis is the recession. Although we can't quantify the economic effect of lost revenues as precisely as we measure the cash drain of fuel costs, the downturn in the economy in the U.S. and Europe has been a serious blow. The recession has severely reduced traffic and made it impossible to pass through to customers the higher costs of fuel. Also, the deep concerns of individuals, families, and business of all sizes about their financial stability contribute to an alarming reaction to the threat of terrorism, which is the third principal cause of the industry crisis.

Air transportation is dependent to a very substantial extent on discretionary travel. Indeed, we are now seeing that even the bedrock business travel is, to a significant extent discretionary. Pan Am has previously felt the consequences of indiscriminate terrorist brutality. Now the entire industry is feeling those consequences.

We understand that transatlantic traffic on all airlines is down over last year by approximately 50% and most if not all of that is attributable to the war and the threat of terrorism. We understand that transpacific travel is down by a like amount. The domestic consequences have not been as great but are still significant. Go out to any airport and look around. At peak times at every terminal, it looks like early Sunday morning.

The safety worry is not going to be resolved immediately by a Coalition victory in the Gulf. Indeed, because of the perverse nature of terrorism such a victory might actually exacerbate the problem for a period.

I must add that the greatest problem with terrorism is the threat. We have confidence in the heightened security procedures which have been adopted, and a lot has been learned and accomplished in the last few years. Nonetheless, until the confidence of travellers is completely restored the U.S. airline industry will continue to experience a severe revenue shortfall.

The Consequences Of Increased Concentration

Increased concentration is clearly inconsistent with the airline deregulation. Take a look at the primary economic goals of deregulation as written into the law:[1]

- the availability of a variety of adequate, economic, efficient, and low-price services by air carriers and foreign air carriers;
- the placement of maximum reliance on competitive market forces and on actual and potential competition;
- the encouragement, development, and maintenance of an air transportation system relying on actual and potential competition to provide efficiency, innovation, and low prices, and to determine the

---

[1] Section 102(a) of the Federal Aviation Act, 49 U.S.C. §1302(a).

variety, quality and price of air transportation services; and

- the encouragement of entry into air transportation markets by new air carriers, the encouragement of entry into additional air transportation markets by existing air carriers, and the continued strengthening of small air carriers so as to assure a more effective, competitive airline industry.

Not one of those goals is consistent with an industry where the three largest airlines control two-thirds or more of the business.

At the consumer level, the most obvious result of increased concentration will be higher fares, both through actual increase and the decreased availability of various types of discounts. There are few industries today that are as price competitive as the airline industry. The types of marginal cost pricing originally envisioned by the drafters of the Deregulation Act exist because of the smaller airlines and the actual and potential competitive threat they pose to the Big Three. But as the industry concentrates and becomes a tightly-knit club, that is going to disappear. From the standpoint of fares, you simply must have competitors to have competition.

From the standpoint of service, there is unlikely to be a shortage of total capacity but the question is how and where will that capacity be deployed? The saving grace, from a service standpoint, of the post-deregulation hub and spoke systems is that there are so many hubs - more than twenty. As many of those hubs are weakened or abandoned, more and more communities, many of them large, will find themselves with highly inconvenient connecting service in even their largest city-pair markets.

Ongoing Federal Initiatives

The Notice addressed five ongoing Federal initiatives and asked for comments on them. I will address each of these initiatives in order.

1. Increased foreign investment. The Department of Transportation's recently announced policy with respect to foreign investment in U.S. airlines does not really create new law. What it does, and this step was welcome, is to create something of a safe harbor out of number of confusing precedents. Two comments with respect to the Department's action.

First, there is nothing inherently wrong with persons who are not citizens of the United States providing capital for the maintenance and expansion of U.S. airlines and the U.S. jobs created by those companies. The subsidy and national security concerns underlying the U.S. citizenship requirement in the current law are thirty to forty years out of synch with the facts. The airline, shipping and telecommunications industries are the only remaining U.S. industries with significant barriers to foreign investment, and the similar citizenship definitions in the shipping and telecommunications industries are applied in such a way as to permit meaningful foreign investment.

Capital is capital, without regard to its source. Capital creates and preserves jobs. Capital creates airline competition. To the extent that the U.S. airline industry remains an attractive long term investment for persons outside the U.S., everything possible should be done to encourage such investment.

We have already seen major benefits from foreign investment in America West, Northwest and Continental. In our view, the Congress ought to support the DOT's recent policy statement and move promptly to expand such opportunities. Specifically, the Congress should reduce the requirement of U.S. citizen ownership of voting securities from 75% to 55% or 51%. Alternatively, the Congress should give the DOT Secretary discretionary power to exempt transactions involving foreign investment up to the 45% or 49% level where certain public interest goals are met. These policy goals would be the preservation of U.S. airline jobs, the necessary strengthening of U.S. carrier competition, and the promotion of a more balanced U.S. airline industry.

This is probably the single most effective step the Congress could take to reach these goals. Our critical need is for new capital infusions and we must search beyond our U.S. geographic boundaries to find additional investors.

2. **Cabotage**. The Committee asked for our views on the cabotage issue. Pan Am is opposed to changing the statutory prohibition on granting purely domestic U.S. traffic rights to foreign airlines. Although no other country is even considering such a step for itself, many foreign airlines are seeking

cabotage rights in the U.S. Pan Am knows how they feel since we were denied domestic traffic rights in our own country for 50 years.

The principal objections we have are three. We can't survive the adverse impact of "cream-skimming" flights by foreign airlines focused on Pan Am's major domestic routes such as New York-Miami and New York-Los Angeles. we see the Europeans moving to either eliminate or freeze our own existing traffic rights within Europe, for which the U.S. has paid, by formation of the Europeans Community. And most important, we see granting cabotage as a major disincentive to the foreign investment that we badly need. Through foreign investment in U.S. carriers, foreign carriers can obtain a cooperative share in U.S. markets while the U.S. maintains control and continues to compete overseas.

3. Fuel cost intervention. The release of 1.2 million barrels per day from the Strategic Petroleum Reserve was a helpful political signal to stabilize the cost of jet fuel. And even that one step was delayed until the Coalition's military action started in January. It does not, however, address the underlying causes of the price increases, causes which include the madness of the commodities market and the unusual, to say the least, pricing policies of the oil companies. Recognizing that this Committee does not have jurisdiction over the commodities markets or the oil companies, still it would be helpful and

appropriate to investigate the irrational high prices of aviation fuel.

4. CRS regulation. There is no question that the dominance of the retail distribution network achieved by American and United through their SABRE and APOLLO computer reservations systems has had an adverse impact on airline competition. It has affected market share, it has affected distribution patterns and it has also substantially increased the costs of their competitors.

Pan Am, for example, pays approximately $1.3 million per month to SABRE and APOLLO for Pan Am passengers booked through travel agents using those systems. The real price per passenger booked exceeds $2.50 for each segment of the passenger's trip. There is no real debate that these fees are excessive. Based on the DOT factual studies, a conservative estimate would be that they are at least twice the actual costs plus a reasonable profit, but we have no choice - we either pay the fees or lose the traffic.

The Department of Transportation has had proposals to strengthen the CRS rules before it for over one year. Secretary Skinner recently indicated that they would act on those proposals "soon." We welcome whatever action the Department can take to make the rules more effective, but it will all be temporizing unless the Department is prepared to address the monopoly pricing issue. I would add that even if the Department were finally prepared to address that issue and the booking fees were lowered to fair levels, that alone would be only a small step in dealing with the immediate capital crisis.

5. The sale of international routes. The Department presently approaches route sales and transfers on a case-by-case basis. The inquiry in each case is the same. Will the sale and transfer promote competition by maintaining the viability of the selling airline while maintaining effective U.S. flag competition on the route? Pan Am obviously endorses this policy.

The suggestion that there is something per se wrong with selling international route authority ignores several crucial facts. First, usually the selling airline has invested heavily over many years in development of the route and has built the business. Secondly, you have to consider the alternative. In many cases, and certainly in the case of the recent Pan Am-United transaction, the alternative was greatly weakened U.S. flag competition on the routes in question and loss of competition over the rest of its system. The transfers will put strong U.S. flag competition on those routes while providing needed capital to enable Pan Am to reorganize and continue as a competitive carrier.

This is not to say that in every case the sale and transfer of a route must be approved. If the sale would not assist the selling carrier to remain an active competitor there might be legitimate concerns about trafficking in franchise rights. Under the Department's approach, such a liquidation type of transaction would be likely to be disapproved.

Reregulation

Pan Am does not support reregulation of airline service and rates, and I would venture to say that few if any of the people in this room would take a different position if they remember what it was like. But that is not the real question. The real question is whether the Congress will be able to resist the popular pressure to reregulate if the concentration scenario I have set forth actually occurs.

Think about your own constituents next year and later if we have an industry absolutely dominated by the Big Three. Fares will be higher, discounts will be fewer and far between and low fare initiatives will be a memory. Nonstop service (and perhaps all service to smaller communities) will be less common, and the available connecting service will be through fewer and often less conveniently located hubs. It will be an airline industry significantly less competitive than the industry before deregulation.

Consumers are not interested in regulation or deregulation. They are interested in price and service, and they will look to the Congress to correct any deficiencies in those regards. Economic and political theory will explain how it happened but that won't restore competition or the prices and services the public wants.

As I said, it is not whether you are for or against reregulation. What matters is what you are prepared to do today to preserve this industry.

Conclusion

In conclusion, we are faced with a crisis such as the airline industry has never faced before. The economic environment, with war, recession, fear of terrorism, excessive fuel prices, etc. is quite simply disastrous for the air transportation business. The capital has been rapidly drained out of all but a few carriers. New capital, whether equity or loans, is not available from U.S. financial sources, either private or the government. Unless the Congress is prepared to consider a guaranteed loan program to support the weaker carriers, at least you must support and assist the limited measures I have addressed here today. Principally, the Congress must allow the continued sale of assets, including international route operations, and expand our opportunity to attract foreign investment.

I appreciate the opportunity to express these views, and I would be glad to address any questions you might have.

Statement of

Steven A. Morrison
Professor of Economics
Northeastern University
Boston, MA 02115
617-437-3646

before the

Subcommittee on Aviation
Committee on Public Works and Transportation
U.S. House of Representatives

February 5, 1991

Mr. Chairman, it is my pleasure to be here today to talk about the adequacy of competition in the airline industry. My comments are largely based on ongoing research conducted with Cliff Winston for the Brookings Institution.[1] Many people predicted that airline deregulation would result in many carriers, perhaps hundreds, with many providing only point-to-point service in a particular market niche. It was predicted that competition would flourish, bringing with it low fares. We certainly have not ended up with many carriers. On the contrary, only a handful of carriers remains in the industry; the only question is how small that handful will become. I believe the reason for the inaccurate prediction was the failure of analysts to appreciate the overwhelming importance that hub-and-spoke route systems would have in the deregulated marketplace.

When assessing the degree of competition in the airline industry most analysts refer to the "national" market. For example, they cite that in 1978, before airlines were deregulated, the largest eight airlines accounted for about 82 percent of domestic passenger miles. Today this figure is about 92 percent (having fallen to a low of about 72 percent in 1985 before the merger wave began). By way of comparison, the beer industry in the U.S. is about the same size as the airline industry ($50 billion in annual revenue) and is more concentrated with the largest *five* firms controlling over 90 percent of the market. However, there is no "national" market for passenger miles or for beer. Just as beer markets are thousands of stores and bars, the markets for air transportation are thousands of point-to-point city pairs: Washington to Dallas, Chicago to New Orleans, and New York to San Francisco, to name only a few. Competition flourishes at this level. As detailed in

---

[1] Although the results of joint work are presented, the views expressed are those of the author.

Figure 1, the number of effective competitors per route[2] has risen from 1.54 in 1978:4 to 1.96 in 1990:2, just 0.04 below its all-time high of 2.0 in 1986:2.

Another perhaps more intuitive way to look at the extent of route-level competition is detailed in Figures 2 and 3. These show the percentage of air travelers who travel on "competitive" carriers (i.e., those with a route market share less than 20 percent) and those who fly on "monopoly" carriers (i.e., those with a route market share greater than 90 percent). The percentage of passengers captive to monopoly carriers has been cut nearly in half: from 26 percent in 1978:4 to 14 percent in 1990:2. During that time the percentage of passengers flying on competitive carriers more than doubled, from 8 percent to 18 percent.

As an exaggerated example, which is preferable, 100 carriers nationwide with one on each route, or five carriers nationwide with 5 competitors on each route? I believe that most people would prefer the latter. However, there is a concern with having only a few carriers nationwide that compete with each other in many city-pair markets: collusion. Some analysts believe that the similarity of air fares on rival carriers is evidence of collusion. However, my work on the factors affecting travelers' choices of airlines indicates that a fare difference of only $10 (for two otherwise identical carriers) is sufficient to cause the higher-priced carrier's market share to fall by 7 percentage points—a sizable loss. Since airlines produce very similar products it is not surprising that fare differences are small.

Another area of concern is the increased domination of carriers at hub airports. Once again, measurement is the key. Nonetheless the vast majority of studies, mine included, find that regardless of route concentration, higher airport concentration leads to higher fares. But do consumers at hubs suffer? This is harder to answer because cities that are hubs receive better air service than they would if they weren't hubs. My research indicates that the average hub has direct service to 75 percent more cities and 120 percent more daily departures per city served than it would if it weren't a hub. Travelers at hubs pay higher fares, yes, but they receive a higher quality product. However, I believe that because hub and spoke is an efficient system that is less costly for airlines than point-to-point transportation airline profits are higher on their hub operations than at other airports.

---

[2] The number of effective competitors is the inverse of the Herfindahl index. Rather than a simple count of the number of carriers in a market, the Herfindahl index adjusts for unequal market shares by summing the square of each airline's market share. Thus, if two airlines each had a fifty percent market share on a route, the Herfindahl index would equal $(.50)^2 + (.50)^2 = 1/2$. Inverting this gives 2 (effective competitors). The inverted figure has a more intuitive interpretation than the Herfindahl index.

But the issue of concentration at the "national" level, at the airport level, or at the route level is of interest because of its effect on fares. Figure 4 shows that after adjusting for input price changes,[3] domestic airline yield (revenue per passenger mile) in 1990:2 was 5 percent below what it was in 1978:4.

But one should not interpret these figures as indicating that deregulation lowered fares by only 5 percent. First, the graph does not include the effect of free tickets awarded under airlines' frequent flier programs. Second, deregulation effectively began in 1976 when the Civil Aeronautics Board began a more liberal interpretation of existing statutes. Between 1976 and 1978 airlines' costs increased by 20 percent but air fares increased by only 4 percent. Furthermore, in a more detailed analysis I calculated what fares would have been if they continued to be set in the way they were under regulation. This is shown in Figure 5. During the 11 years of deregulation, fares on average are 18 percent below what they would have been if regulation continued. This amounts to a saving to air travelers of about $6 billion annually (1988 dollars).

Now I would like to address more directly some of the issues that are the focus of this hearing. Although I have no crystal ball, one is not needed to say that the current financial condition of the industry is not good and it will not improve if fuel prices remain high or if the recession or war-related traffic slumps are protracted. I would not be surprised, especially given the dramatic decrease in international bookings recently, to see another carrier fail. Financially troubled airlines will sell assets in an attempt to survive. Of course, the best assets to sell are those that are most valuable, leaving such airlines with less to work with. So unless the affected companies make significant structural changes, asset sales will only delay the inevitable.

The airline industry has always been a cyclical one. Reregulation cannot change that. The current recession is one of the causes for airlines' poor financial performance. Second, the run up in fuel prices saw the price of jet fuel more than double. This has had a large impact on carriers' finances because fuel is airlines' second largest cash expense. Financially weak carriers are especially vulnerable because they tend to own older less fuel efficient aircraft. Fuel prices are now only 14 percent above their level during the first week in August, but this obviously could change in the weeks ahead. Deregulation's role in all this is that there is no longer a regulator to intervene to arrange mergers with healthy carriers to stave off bankruptcy. Airlines must arrange these on their own and be subject to antitrust scrutiny.

---

[3] In this graph, I do not adjust by the Consumer Price Index, which shows how the price of a basket of goods purchased by consumers has changed. Instead I adjust by the Air Transport Association's Airline Cost Index, which measures the changes in prices that airlines pay for their inputs (labor, fuel, etc.).

With respect to increased concentration, as I mentioned earlier, although there are fewer carriers nationwide, there is nearly as much competition today *at the route level* than ever before. I expect the consumer benefits of deregulation to continue. But this does not mean that deregulation in 1991 and beyond will offer fares as low as in 1986.

The central question is, however, is there a role for the federal government in enhancing competition in the industry? Let me list and evaluate several areas that have been suggested from time to time.

Foreign ownership and entry into domestic city pair markets

I believe this would be beneficial to travelers. I believe the burden of proof should be on those opposing foreign ownership and entry.

The cost of fuel

The cost of fuel has fallen over the last 17 weeks so that it is now only 14 percent above its level during the first week of August. Nonetheless, if there is reason to believe that the behavior of fuel suppliers is anticompetitive, this should be dealt with even if the airline industry were not experiencing financial hardship. On the other hand, if the fuel industry is behaving in a more-or-less competitive way yet the airline industry suffers, so be it.

Frequent flier programs

I have mixed emotions about frequent flier programs. On the one hand, they are ways for companies to develop "loyal" customers. On the other hand, one troubling aspect of frequent flier programs is that they appear to give an advantage to large carriers, but not because large carriers have lower costs. I believe that an in-depth study of frequent flier programs is worthwhile.

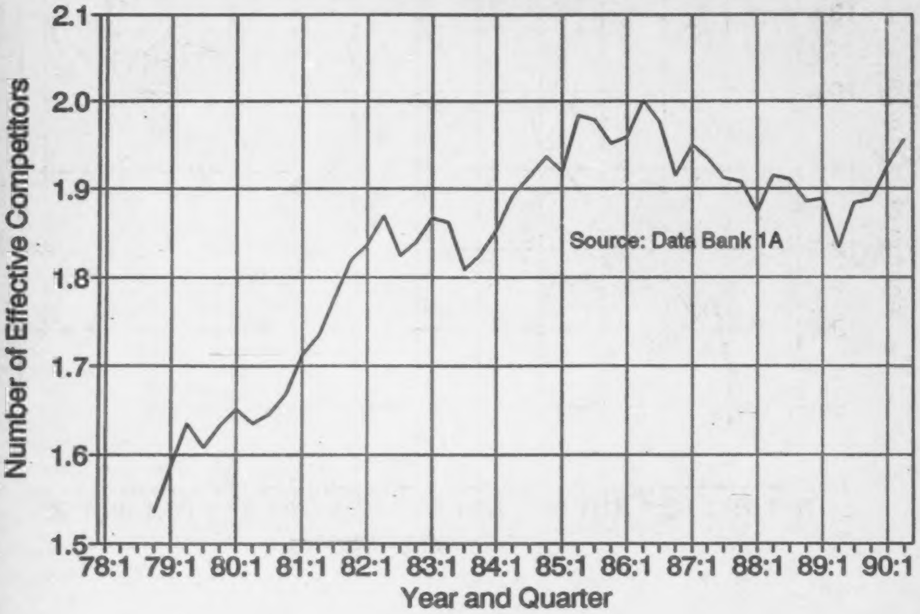
Allowing financially weak carriers to sell international routes

Given that we do not have "open skies" internationally, I believe that the "scarcity value" of these routes should be the property of the U.S. government rather than the carriers that were selected to serve them. (This is also my view on the ownership/sale of airport slots that were given to carriers.) However, it is clear that airlines and financial markets had every expectation that current route authority is an asset belonging to the carriers involved. My view is that any additional international route authority not be subject to sale.

The final issue is whether there should be reregulation of routes or fares. To the extent that there are competitive problems in the industry, I believe they stem mostly from airport access issues. The institutional/contractual arrangements between airlines and airports date from the regulated era when issues of competitive access were not relevant. I believe that current practices, such as long term leases, majority in interest clauses, and slot ownership and sale, should be looked at in depth to see to what extent they do, in fact, reduce competition and appropriate action should be taken. However, I do believe that fare or entry regulation would be a step, perhaps only the first of many, in the wrong direction.

Thank you, Mr. Chairman.

Figure 1



Average Number of Effective Competitors Per Route

Source: Data Bank 1A

Figure 2

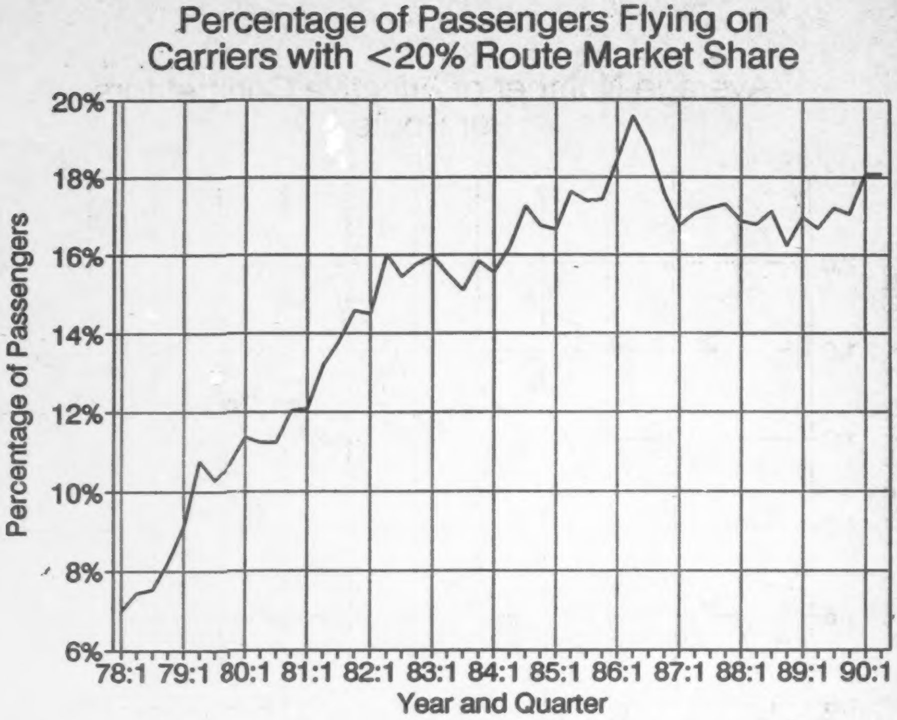

Percentage of Passengers Flying on Carriers with <20% Route Market Share
20%
18%
16%
14%
12%
10%
8%
6%
Percentage of Passengers
78:1
79:1
80:1
81:1
82:1
83:1
84:1
85:1
86:1
87:1
88:1
89:1
90:1
Year and Quarter

Figure 3

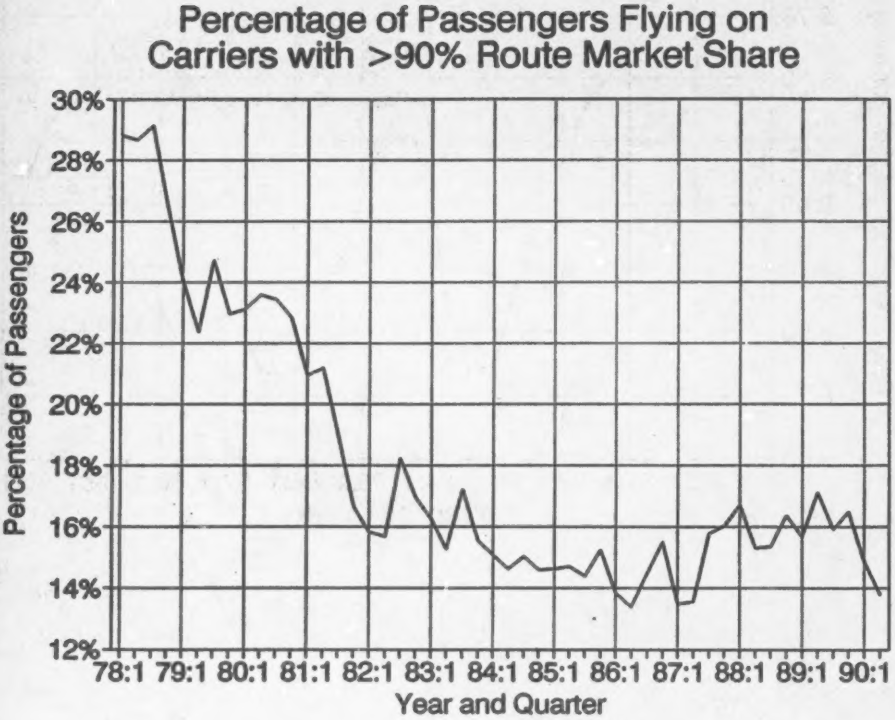
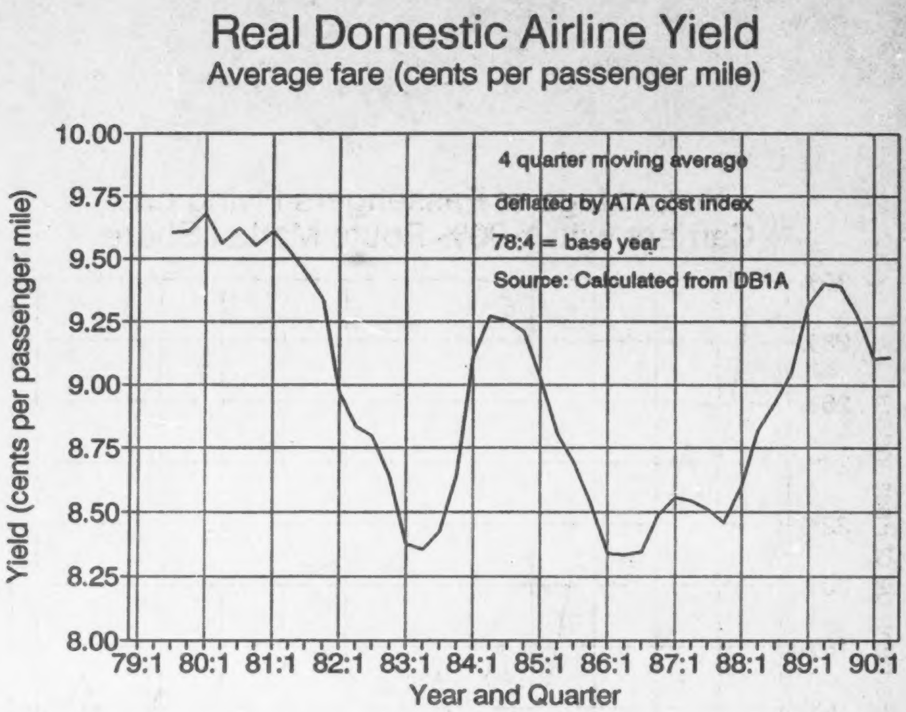

Percentage of Passengers Flying on Carriers with >90% Route Market Share
Percentage of Passengers
30%
28%
26%
24%
22%
20%
18%
16%
14%
12%
78:1
79:1
80:1
81:1
82:1
83:1
84:1
85:1
86:1
87:1
88:1
89:1
90:1
Year and Quarter

Figure 4


Real Domestic Airline Yield
Average fare (cents per passenger mile)
Yield (cents per passenger mile)
10.00
9.75
9.50
9.25
9.00
8.75
8.50
8.25
8.00
4 quarter moving average
deflated by ATA cost index
78:4 = base year
Source: Calculated from DB1A
79:1
80:1
81:1
82:1
83:1
84:1
85:1
86:1
87:1
88:1
89:1
90:1
Year and Quarter

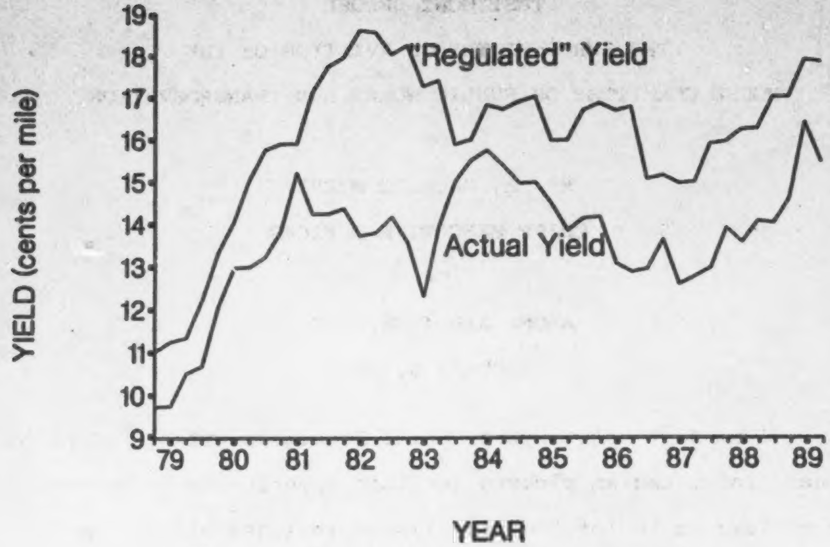


Figure 5 Actual vs. "Regulated" Yield

TESTIMONY BEFORE
THE SUBCOMMITTEE ON AVIATION OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION

OF

MR. A. MAURICE MYERS

CHIEF EXECUTIVE OFFICER

OF

ALOHA AIRLINES, INC.

FEBRUARY 5, 1991

I am A. Maurice Myers, Chief Executive Officer of Aloha Airlines, Inc., and am pleased for this opportunity to present Aloha's views on two of the many issues included within the Subcommittee's agenda:

(1) The impact on competition of the Department of Transportation's recent liberalization of the longstanding restriction against foreign control and ownership of U.S. carriers; and

(2) The large carrier bias inherent in the Department's carrier selection policy.

I would also be pleased to answer any of the Members' questions about the many other issues on the Subcommittee's agenda.

A brief history of Aloha's operation as an interisland carrier serving the Hawaiian Islands and financial performance is set forth in an attached appendix. I am also proud to say that Aloha will report a profit for the just completed year.

Turning to the two issues of principal concern to Aloha.

A. It Is Essential that Congress Set Specific Parameters Governing Any Proposed Liberalization of the Established Foreign Ownership and Foreign Control Restrictions

In 1989 and 1990, Aloha, perhaps more than any other carrier, found itself forced to become an expert in the five decades of precedent setting forth the acceptable limits of foreign ownership and control of U.S. carriers. Aloha was a principal party to the often controversial Discovery Airways proceeding in which a new entrant carrier, whose financing derived entirely from a combination of Japanese and British sources and whose principal officers and directors were financially beholden to a Japanese investor, sought to obtain the Department's approval to become a domestic carrier. It was only after a prodigious effort, which succeeded in uncovering the facts surrounding the actual foreign sources of that carrier's entire capital base, that the Department reversed direction and concluded that Discovery was indeed controlled by foreign investors.

More interestingly, even though Discovery has not operated since mid-July 1990, Discovery's Japanese investors have continued to fund Discovery's more than 140 employees, pay the lease payments on all of Discovery's aircraft and pay all of Discovery's other expenses. In the meantime, Discovery's application before the Department remains dormant while Discovery searches for one or more U.S. citizens prepared to lend their name and, perhaps temporarily, some nominal capital to hold the majority of Discovery's voting stock.

I have intentionally belabored the Discovery situation to focus on the need for the Subcommittee to enact legislation setting forth clear outer limits for foreign control, as well as the foreign ownership, of U.S. carriers. I would suggest for the Subcommittee's consideration that the degree of permissible foreign control of U.S. carriers should be statutorily limited in at least the following manner.

1. There should be a percentage limit--possibly as high as 70%--on the total debt and equity capital which can be invested in any U.S. carrier to assure that there is a reasonable measure of U.S. source capital; and

2. This liberalized foreign control limitation should be allowed only in cases where the foreign investment derives from foreign countries which allow reciprocal U.S. investment and which afford liberal entry, possibly including cabotage rights, to U.S. carriers.

These statutory parameters of foreign control would be in addition to the existing 25% limitation on the foreign ownership of a U.S. carrier's voting securities and the requirement that the president and at least two thirds of the Board of Directors also be U.S. citizens. If, on the other hand, the Subcommittee were inclined to raise the statutory limit on foreign ownership, then the Subcommittee should lower commensurately the overall percentage limit on permissible foreign debt and equity in order to preserve some reasonable measure of U.S. ownership and control.

The establishment of reasonable statutory limits on foreign control as well as the preservation of existing statutory limits on foreign ownership are necessary to enhance, rather than retard, competition among U.S. carriers. While some are suggesting that greatly increased foreign investment in U.S. carriers is the answer to the excessive concentration and financial problems facing the industry, I would respectfully suggest that that is not the case for several reasons.

FIRST, with the exception of Discovery, which involves Japanese investors whose decisions are being driven by factors unrelated to the airline itself, I have substantial doubt that most foreign investors would be interested in investing in the weaker U.S. carriers most in need of new capital. The lessons of JAL's investment in Hawaiian as well as SAS' investment in Continental will linger for quite some time. Whatever investment takes place is almost certainly going to be in the far larger U.S. carriers. While my feelings are intuitive, the odds weight heavily against the liberalization of the foreign investment restrictions resulting in the restoration of the health of the weaker U.S carriers or otherwise easing the excessive concentration within the industry.

SECOND, to allow increased foreign investment means necessarily that we are indirectly allowing investors to enjoy cabotage rights within the United States. Yet, unless the United States has liberal bilateral agreements with the homeland of those foreign investors, which also permits some degree of cabotage for U.S. carriers, increased foreign investment will actually worsen rather than improve the competitive strength of the U.S. carrier industry. As an example, would not the incentive of the Japanese Government to allow U.S. carriers improved access to Japan, possibly including cabotage rights, be greatly reduced if the Government of Japan knew that it could achieve *de facto* access to any and all U.S. domestic markets through the guise of the liberalized U.S. foreign investment policy. How many times must the United States learn the hard way that many of our major trading partners will only give an inch when absolutely forced to do so. That is certainly the lesson of the recent collapse of the Uruguay round of GATT negotiations and, from recent news reports, may also be the lesson of the recent talks with the United Kingdom over Heathrow succession rights.

Competition will be enhanced only by liberalizing the restrictions against foreign ownership and foreign control in return for clearly identifiable improved access to and within foreign countries. Without such a *quid pro quo*, the industry's already severe problems will only worsen.

B. The Department's Carrier Selection Policy in International Route Proceedings Should Be Revised

The Department's criteria for carrier selection applied in international route proceedings, where there is limited entry, should similarly be revised. The explicit public interest factors enumerated in Section 102 of the Act for international markets do not even include the stated statutory objectives--applicable in domestic markets--of:

- The encouragement of entry into air transportation markets by new air carriers,
- The encouragement of entry into additional air transportation markets by existing air carriers and
- The continued strengthening of small air carriers so as to assure a more effective, competitive industry.

While the absence of these objectives in the statutory criteria applicable to international markets has not precluded smaller carriers from receiving occasional international route awards in contested carrier selection proceedings, those occasions have been few and far between. None of the real plums in the three most recent transpacific route proceedings went to any of the smaller carriers. This has occurred because the present carrier selection policy is skewed heavily in favor of the mega-carriers and thus contributes to the excessive concentration which we now find ourselves trying to remedy.

Whether or not the objectives just mentioned are added to the list of public interest factors governing international air transportation, the Subcommittee should make clear to the

Department that its carrier selection criteria should be revised to eliminate the inherent bias favoring the larger carriers. That bias derives from a number of the carrier selection criteria which the Department commonly uses.

The first such factor is the significant decisional weight which the Department accords to the number of beyond-area U.S. cities which can be served with new single-plane and on-line connecting service behind a new route between a U.S. gateway city and a foreign point. In the U.S.-Japan Service Case, in which Aloha pursued the Honolulu-Tokyo route, the fact that Aloha proposed the greatest number of Honolulu-Tokyo seats and was the only carrier which expressed any willingness to pursue a campaign to lower the Honolulu-Tokyo fares was all but ignored. Rather than focus on the pivotal Honolulu-Tokyo market, the Department decided to base its decision in favor of Continental on that carrier's offer to provide Houston-Tokyo single-plane service via Honolulu. The fact that Continental could have provided that same single-plane service on a far more direct and shorter routing via Seattle was discounted inexplicably by the Department.

The Department's carrier selection decisions quite often boil down to which carrier can serve the greatest number of interior U.S. cities. It can surely be appreciated, however, that this market structure criterion favors heavily the mega-carriers with their vast route networks.

Another carrier selection factor, although implicit rather then explicit, is the Department's strong preference that the applicant carrier already operate and have available the wide-bodied aircraft which the carrier proposes to use over a particular new route. This was a criticism directed at Aloha, which proposed B-747 service between Honolulu and Tokyo, even though there was never any doubt that Aloha could have financed the acquisition of such aircraft. In substance, the Department all but requires that an applicant gamble on and assume the risk of committing to either purchase or lease two to three new aircraft long before the Department's final decision is made. That implicit criterion again heavily favors the larger carriers, most of whom have large aircraft orders in place.

This criterion makes little sense. It is irrational to expect a prudently managed carrier to take such an investment risk. Any person familiar with the industry would readily acknowledge that a well-financed smaller carrier just awarded a lucrative international route could easily find suitable aircraft. That is certainly the case with Aloha.

Closely related to the "aircraft-on-order" criterion is the now standard condition that the new service must be started within 90 days--a time period which is often too short to locate, acquire and refit long range aircraft and also arrange for the necessary pilot training. While I can appreciate that there is a miniscule short-term benefit to having new service commence several weeks sooner than might otherwise be the case, the importance of "winning the race to the starting line" does not compare to the pro-competitive benefit of injecting new competition from a smaller carrier, for whom the new route would represent a major new undertaking. For a carrier such as Aloha, the award of a major international route such as the Honolulu-Tokyo route would have provided significant benefits throughout our entire system and would have made Aloha an even stronger competitor over our existing system. That is and should be an undeniable long term-public interest benefit.

The Subcommittee should enact legislation mandating that the Department revise its carrier selection criteria to establish a presumption of significant competitive benefits to be derived from the selection of a smaller carrier when a proposed new route would represent a significant portion of that carrier's system. The Subcommittee should also direct the Department not to rely on the so-called beyond area benefit criterion, the "aircraft-on-order" criterion, or the 90 day start-up condition when, on the basis of the other traditional criteria, the carrier selection decision is narrowed to a choice between a large and small carrier. Without at least a partial leveling of the playing field in the Department's carrier selection route proceedings, smaller carriers will be increasingly left behind as the size differential between those carriers and the mega-carriers increases.

APPENDIX

Aloha Airlines, founded in 1946, operates 18 B-737 aircraft in interisland service. Aloha's wholly-owned commuter subsidiary, Aloha Island Air operates 8 DeHavilland Twin Otter aircraft. Aloha also enjoys a strong reputation for on-time performance, high quality service and the lowest consumer complaint ratio in the industry.

Aloha has also operated a profitably for 17 of the past 20 years, including steady profits for the past six years.

STATEMENT

OF

JOHN F. PETERPAUL

VICE PRESIDENT-TRANSPORTATION

INTERNATIONAL ASSOCIATION OF

MACHINISTS AND AEROSPACE WORKERS

BEFORE THE

SUBCOMMITTEE ON AVIATION, COMMITTEE ON PUBLIC WORKS

AND TRANSPORTATION

U.S. HOUSE OF REPRESENTATIVES

ON

FEBRUARY 5, 1991

My name is John F. Peterpaul. I am the Vice President for Transportation of the International Association of Machinists and Aerospace Workers ("IAM") and am a Vice President of the Transportation Trades Department ("TTD") of the AFL-CIO. The IAM represents approximately 800,000 employees in various industries throughout the United States and Canada. We are the largest union in the air transport industry representing 95,000 mechanics and related employees. The TTD of the AFL-CIO is comprised of 25 unions with representation in the transportation industries.

At the outset I would like to thank Chairman Oberstar and all members of his committee who provided the IAM and the TTD with the opportunity to express our concerns regarding the financial condition of the airline industry and the woeful failure of deregulation. We wish to give special thanks to Chairman Oberstar for his efforts and vigilance in assuring that our nation's air transport system and its employees remain the finest in the world.

More than a decade ago when legislation to deregulate the air transport industry came before this Congress, the IAM forcefully opposed it. We strenuously argued that deregulation would mean destabilization of the airline industry. We argued that the bill which masqueraded as a pro-consumer measure would in fact result in far less competition, higher air fares, a reduction in the margin of safety due to cost cutting in maintenance, as well as hardship and unemployment for many airline workers. We take no pleasure in the fact that our worst fears have come to pass.

Carriers since deregulation have resorted to the economic law of the jungle. National Airlines, Republic Airlines, Piedmont Airlines, Ozark Airlines, Eastern Airlines, are a few among the approximately fifty casualties of deregulation. Unfortunately, the deregulated environment became the playground for experts in corporate greed, such as Frank Lorenzo, who bankrupted and destroyed Eastern Airlines and placed its sister carrier Continental into bankruptcy for a second time. Now Pan American Airlines, after selling most of its valuable assets, has recently sought protection from its creditors through a Chapter 11 filing. Other carriers are teetering on the brink.

Our organization and the employees we represent are particularly disappointed at the inaction of the Department of Transportation. The DOT has been sitting on its hands while watching this industry go into a downward spiral. In the fourth quarter of 1990 not a single major U.S. airline has reported an operating profit. Even the strongest carriers in the industry have experienced record losses during this period. United, American and Delta each suffered operating losses in excess of a quarter of a billion dollars. Frankly, we are shocked that our Secretary of Transportation would state in his speech at the National Press Club a week ago that "we must stay the course in the coming decade as the industry continues to restructure." Staying the course while the industry continues in a tail spin will guarantee disaster.

A situation which is terrible will be permitted by our Secretary to become worse. Right now airlines are not covering their operating costs. Moreover, with our worsening recession, domestic travel will continue to decline. In addition, the cost of jet fuel has risen dramatically since Iraq's invasion of Kuwait in August. Even a one cent increase in the cost of a gallon of jet fuel results in a nearly $200 million burden on the industry as a whole.

We take particular offense at the Secretary's unfounded comment suggesting that because some airlines pay less than the industry standards all employees should be reduced to the lowest common denominator. Frank Lorenzo proved at Eastern and Continental that in a service industry inferior wages and working conditions are a sure recipe for failure. Secretary Skinner's anti-worker, anti-union sentiment unfortunately has been the hallmark of this and the previous administration. His attack on the Railway Labor Act as outmoded is absurd and completely outside of his Department's area of jurisdiction and expertise. It is obvious from his comments that the Secretary has little understanding of the great success the Railway Labor Act has had in stabilizing the industry and preventing work stoppages.

The worst example of the sorry state of this industry is undoubtedly Eastern Air Lines. The safe harbor that the bankruptcy court was intended to provide a debtor could not protect Eastern against the market forces that have battered the rest of the industry. Despite Mr. Shugrue's prediction in late November of a break-even operation by March of this year, Eastern's results were so devastating that it was forced to cease operations on January 18. Since it filed for bankruptcy in March 1989 Eastern has squandered over $700 million in proceeds from asset sales. It is hard to believe that the creditors of Continental and Pan Am will not have learned from the Eastern experience. Creditors will demand viable plans of reorganization within the statutorily set period of 120 days or they will seek a guaranteed recovery through liquidation. Even those carriers that deserve a chance to survive reorganization will be quickly dismantled in the coming months by anxious creditors.

According to Pan Am, its survival is dependent upon the consummation of the sale of its London routes to United. Based upon this transaction Bankers Trust has advanced the airline $150 million which Pan Am is obligated to repay in March. Similarly, TWA stated last week that if the sale of its London routes to American is not completed shortly, TWA will be compelled to file for bankruptcy. However, the negotiations between the United States and Great Britain over a new treaty that would permit the transfer of these routes broke off last Wednesday. It is indicative of the worsening condition of the airline industry that the future of two major carriers now rests upon whether they can sell off foreign routes which arguably belong to the United States.

The causes of the industry's financial difficulties are not a mystery. Deregulation coupled with a weakened economy has shrunk airline revenue while increased fuel costs have played havoc with the expense side of the carriers' income statements. As a result of the war in the Persian Gulf travel to Europe has especially been affected. United reported on Thursday that "its load factor, or the percentage of seats filled, on trans-Atlantic flights has plummeted to a range of 30% to 39% from about twice as much" (Wall Street Journal, February 1, 1990, p. A4). Although a carrier as financially secure as United may be able to withstand such significant traffic fluctuations, there is serious doubt that the weaker airlines can tolerate such a massive loss in revenue.

No one with any credibility in this industry believes any longer that the invisible hand of the free market place will somehow correct the failures of deregulation. Instead, there can be no doubt that without decisive and immediate government intervention, the impact of the recession, the war, fuel prices and impatient creditors will push a number of carriers over the brink into bankruptcy and liquidation. The worst results of deregulation will be accelerated.

Secretary Skinner turns a blind eye to the fact that already in Atlanta, Pittsburgh, Minneapolis, St. Louis, and Charlotte, a single carrier controls more than 75% of the market. He ignores the fact that in Detroit, Houston, Chicago and Dallas - only two carries control more than 75% of the market. I am afraid the only competition that remains is the race for a monopoly in the few remaining locations where some competition exists.

We are dismayed and angry that the current administration is looking to Europe or Japan to cure what ails our airline industry by permitting foreign ownership of domestic airlines to increase from 25% to 49%. High fuel costs, economic recession and a foreign war are relatively short term problems. Mr. Skinner's cure --

foreign investment -- may have an immediate short term benefit but will turn over one of our proudest and most important American industries to foreign control. We interpret Mr. Skinner's call to get ready for increased "globalization" of the airline industry as paving the way for the loss of still another American industry. His unilateral proposal to permit increased foreign control over domestic airlines is nothing more than a political ploy. There must be a better way to reward our allies for their support in the Persian Gulf. Mr. Skinner's proposal will most certainly lead toward a handful of foreign controlled carriers overseeing transportation within the United States.

Even less acceptable than increasing the allowable percentage of foreign ownership is allowing foreign carriers, many of which are subsidized by their own governments, to fly domestic markets within the United States. This proposal, if implemented, will only insure the demise of our airline industry.

Mr. Skinner said that his policies would create competition "like we've never seen before." If he opens up the domestic market, we will see foreign government subsidized competition like never before all right. But we will also see the last of our domestic carriers.

Just last week, Jeffrey Shane, the Assistant Secretary of Transportation for Policy and International Affairs, attacked the auction of international routes in bankruptcy proceedings, saying that international route transfers between carriers were one of the ways that the U.S. airline industry is positioning itself for the future. Mr. Shane observed that "Where routes and slots merely go to the highest bidder, it's clear that important public policy objectives are likely to be sacrificed." These transfers, he stated, should not be determined "through a numbers exercise in the bankruptcy court [but] through DOT and Justice Department oversight and enforcement." My question to Mr. Shane is: where have you been all these years when airline after airline devoured its competitors and loaded up unsustainable debt burdens? Where was the DOT when the IAM told you during the Fitness Investigation of the Texas Air Corporation that the company could not sustain the mountains of debt that Mr. Lorenzo had accumulated?

Mr. Skinner said in his speech that deregulation has been a stunning success and asked that we stay the course. No one, not even Alfred Kahn, believes that. If we have learned anything in the decade following deregulation, it is that we are desperate for a mid-course correction. The IAM believes that this country needs a new federal agency -- not the Department of Transportation -- to coordinate and review airline pricing policies within zones of reasonableness to assure that we maintain our domestic airline capability and protect the consumers and employees who are the victims of the economic warfare within the industry. We need an agency whose sole and exclusive mandate is the protection of the airline industry, consumers and workers. We need a degree of re-regulation and we need it immediately.

TESTIMONY OF NORTHWEST AIRLINES

HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
SUBCOMMITTEE ON AVIATION
Hearings on
The Financial Health of the Airline Industry

February 5, 1991

Elliott Seiden
Vice President, Law and Government Affairs
Northwest Airlines, Inc.
901 - 15th Street, NW
5th Floor
Washington, D.C. 20005
(202) 842-3193

Introduction

Good morning, Mr. Chairman. I am Elliott Seiden, Vice-President, Law and Government Affairs of Northwest Airlines.

Participation in CRAF

Before addressing the major -- and important -- topic of this hearing, I would first like to report on the front-line role the airline industry is playing in Operation Storm. As part of the Civilian Reserve Air Fleet (CRAF) program, U.S. airlines have carried over 60% of all troops and over 20% of all cargo to the Middle East. Northwest, and I am sure I speak for the entire airline industry, is pleased and proud to be a part of this effort.

Crisis Facing the Industry

The airline industry has been a proud participant in our war effort, but it has also been a casualty of the war.

Even before the outbreak of the war, the recession had substantially dampened both business and personal travel by air.

Since the outbreak of hostilities in the Middle East, demand has dropped even more precipitously. The U.S. airline industry, in cooperation with the FAA and domestic and international airport authorities, has taken extraordinary steps to increase security to protect our passengers. These measures, we are confident, provide our passengers the highest level of security. Nonetheless, discretionary vacation travelers and even business travelers have been canceling or postponing air travel plans.

International air travel across the Atlantic and Pacific has plummeted. We have been forced to cut our overall service to international destinations by 17%, including flights to London, Paris, Frankfurt and Tokyo. Other U.S. carriers have had to cut back as well.

In addition, in the months following the Iraqi invasion of Kuwait, airlines faced dramatically increased costs of jet fuel. Notwithstanding the abundant worldwide supply of oil, speculation and the fear of a shortage drove the price up to more than double the pre-invasion levels. The price of jet fuel rose faster than the price of crude oil, and even though the price has dropped in recent weeks, it remains 15% higher than the price prior to August 2nd. Furthermore, the airline industry bore the brunt of the fuel price increases: while the prices of wholesale gasoline and home heating oil increased 38% and 65% respectively, jet fuel prices rose 120% during the same period.

Finally, the ability of the industry to attract capital has been seriously hampered due to the savings and loan and banking crises.

The cumulative result of the convergence of these events has been an unprecedented level of industry wide losses. During the fourth quarter of 1990, virtually every carrier lost money and the industry as a whole lost approximately $1.7 billion, raising the total 1990 losses to over $2 billion -- more than double the industry's previous record loss during the recession in 1982.

Need to Raise Capital

The problems which plague each airline vary. However, the overriding threat to the long-term viability of even the healthy carriers is the difficulty of capital formation during this turbulent period and perhaps beyond.

The need to raise capital is particularly critical in the airline industry. Simply put, aircraft are expensive. For example, the average cost of a new Stage 3 aircraft is approximately $44 million. Yet, airlines must order aircraft years in advance of actual aircraft delivery tailored to passenger traffic years in the future.

The capital formation problem predates the Iraqi invasion of Kuwait, although the crisis in the Gulf has certainly exacerbated it. The industry has difficulty raising capital mainly because the industry has not been profitable. Investors, both large and small, are simply not interested in investing money in a company, or in an industry, that does not provide a fair return on investment.

The Industry is highly competitive

The financial state of the industry belies an oft stated public perception that airline fares are excessive. The Department of Transportation, in an exhaustive study released in February 1990, determined that since deregulation, inflation adjusted yields have decreased. The General Accounting Office, as recently as November 1990, concluded that since deregulation even fares at small and medium sized airports had decreased on an inflation-adjusted basis.

However, for us, to paraphrase, "the proof is in the profits" -- or, in our case, "the lack of profits." If the current industry structure were an oligopoly, as many have claimed, or a monopoly on many routes, the industry would be making money rather than registering record losses.

The overall lack of profitability of the industry also discredits the concern that fares and the percentage of enplanements are higher at so-called "fortress hubs". The critical -- and only relevant -- issue is whether the traveler has a choice of service among competing airlines for reaching a particular destination. As shown by the DOT, since deregulation, consumer choice has significantly increased in terms of frequency, timing and routing of flights. DOT has noted that more than one-half of all passengers traveled in markets with three or more competitive carriers in 1988 compared with only one-quarter in 1979.

Even at our largest hub, Minneapolis/St.Paul, Northwest faces competition from 18 major and regional carriers providing competition on virtually every route we service. And the competition is real. If American or United cuts its fare from MSP to Washington D.C. or America West cuts its fare to Las Vegas or Phoenix, Northwest will need to match that fare and service -- or lose the business.

Adverse Impact of Congressional Action During the 101st Congress

Congress must recognize the precarious financial state of the industry, and the fierce competitive environment. We are concerned that Congress did not do so when, less than three months after the Iraqi invasion, it enacted legislation which placed an enormous additional financial burden on airline passengers and the airline industry.

The cumulative effect of last year's Congressional action is worth detailing for your Committee's consideration:

Stage 2 Phase Out: The Stage 2 phaseout requirement will force Northwest and other airlines to retire numerous aircraft well before the end of their useful lives. These aircraft will need to be replaced with new, more expensive, Stage 3 aircraft. The biggest loser in this premature phase out will be the residents of small communities who rely on the smaller aircraft to provide service. Without these aircraft in service, millions of passengers will face reduced service or no service at all. These reductions in service will, of course, also mean lost revenue for the airline.

Fees and Taxes: In addition, Congress imposed a series of new fees and taxes on the airline industry and its passengers.

- Passenger Facility Charges, which may be as high as $6 per passenger on a one-way trip, will dampen travel. Although the purpose of PFCs is reportedly to provide funds for airport improvement and expansion, airline passengers have already paid over $7 billion into the Aviation Trust fund, which remains unspent, for the very same types of projects which will now be funded by PFCs. DOT has estimated that this fee will cost airline passengers approximately $6 billion over five years.

- Airline ticket taxes were increased from 8% to 10%. This tax was actually scheduled to be reduced because the monies were not being spent for the dedicated purpose of airport improvement and expansion. Instead, the taxes were increased and a portion of the revenues were diverted to deficit reduction. These increases will cost airline passengers an additional $11.8 billion over five years.
- Taxes to fund agencies: Numerous other committees imposed fees on the airline passenger to fund agencies, including the Animal Plant Health Inspection Service (APHIS), the United States Travel and Tourism Administration (USTTA), and the Immigration and Naturalization Service (INS).

The U.S. airline industry and the U.S. government have had an excellent working relationship: working to create the finest, safest air transportation system in the world. However, recently the government's approach to the industry has been piecemeal: new regulations, new fees, and new and increased taxes. It is the cumulative effect of these actions -- not necessarily any specific tax or regulation -- which has resulted in an extraordinary burden on the industry. A burden which -- added to the disastrous effects of the war and recession -- has crushed at least one airline in recent months, and may topple many more in the coming months.

KLM Investment

Finally, the Committee has specifically asked that we address the foreign ownership issue and KLM's investment in Northwest. The KLM investment has been an important source of capital for the Company in an otherwise difficult market. The investment is completely consistent with the U.S. citizenship and control requirements of the FAA Act, and, most importantly, has not resulted in control by KLM of Northwest in any manner.

The bulk of KLM's unrestricted investment consists of preferred stock which has characteristics of subordinated debt. Like debt and unlike equity, the holders have no right to vote, except to prevent dilution of their interest, and cannot nominate directors.

Even after a planned stock conversion, the percentage of foreign ownership of voting stock and the percentage of non-U.S. citizens on the Board of Directors will remain below the statutory threshold. Most importantly, Mr. Checchi, Mr. Wilson and Mr. Malek will still own a majority of the voting stock and will continue to control the company.

Finally if Congress determines that the foreign ownership laws should be liberalized only if other countries liberalize their aviation regimes, the KLM investment is an excellent model. As recently noted by Secretary Skinner, the Netherlands has a liberal bilateral aviation policy with the U.S.: In 1977 the Netherlands was the first country to sign an open bilateral agreement as requested by the U.S.; and currently U.S. airlines may fly from any U.S. city to the Netherlands, and from the Netherlands to any European city (unless prohibited by the other European country.)

* * *

I have appreciated the opportunity to present the views of Northwest, and I would be pleased to answer any questions.

STATEMENT OF SECRETARY OF TRANSPORTATION
SAMUEL K. SKINNER

BEFORE THE
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION,
SUBCOMMITTEE ON AVIATION

CONCERNING COMPETITION IN THE AIRLINE INDUSTRY
FEBRUARY 5, 1991

Mr. Chairman and Members of the Committee:

I am pleased to have this opportunity to appear before you to discuss recent developments in the airline industry.

The airline industry is going through a very difficult period, and no one should try and gloss that over. Eastern Airlines has ceased operations; Continental and Pan American are currently operating under the protection of the bankruptcy courts; and the U.S. airline industry as a whole has just experienced an annual loss estimated to be $2 billion for 1990--the greatest one-year loss in its history. Most of this loss occurred in the last quarter of 1990 and has led to a flurry of proposed transactions among airlines.

The Department has worked diligently over the last two years to understand the changing nature of the airline industry and to set in place a framework for policy action. One of my first acts as Secretary was to begin the most comprehensive study of the airline industry ever conducted. It was completed just about a year ago and clearly demonstrated that airline deregulation has resulted in substantial benefits for travelers.

The National Transportation Policy, also completed last year, provided the Department with the policy framework to move forward on aviation reauthorization.

Last year's reauthorization legislation is the most significant aviation legislation since airline deregulation. One of the most pro-competitive features of the reauthorization can be directly credited to this Committee and you, Mr. Chairman, and that is the new statutory power provided local airport authorities to initiate Passenger Facility Charges to finance airport expansion. The Department was an early and ardent proponent of that significant pro-competitive authority. PFC's will allow the industry to expand significantly in the future. Anticipated PFC revenue streams can support more than a billion a year in new bonding. Many airports are eager to begin participating in this program, and we have today published a notice of proposed rulemaking which will allow a PFC rule to be in place to meet the July 1, 1991 deadline.

This landmark legislation also maintained significant airport grant levels, approaching $2 billion annually, which can translate directly into capacity enhancement and more competition at our largest hubs. These levels had my personal support.

The Department, the Congress, and the industry, working together, also established a comprehensive policy to deal with the environmental problem of aircraft noise. The Act's noise provisions will provide relief for two-thirds of all affected Americans by the end of the decade. This policy puts the United States ahead of all nations in addressing aircraft noise, and will also result in a much more fuel efficient U.S. fleet.

So I believe we have accomplished a great deal over the last two years to provide a sound long-term environment for a competitive and healthy airline industry. Later, I will summarize more recent steps I have taken or plan to take which will aid the carriers in dealing successfully with current economic circumstances and help them to emerge from this difficult period as vigorous competitors.

The airline industry's recent troubles should not be read as an indictment of deregulation. As you know, the Department's study of airline deregulation documented in great detail the enormous benefits deregulation has provided for American travelers, and our ongoing analysis of the industry gives us confidence that these benefits will continue. Other credible studies, such as those conducted by the Brookings Institution, have confirmed our results.

To summarize briefly what our study and ongoing analysis have concluded: First, airline travel is much less expensive. Real airline fares in the United States have declined by an average of 28 percent since 1981. Second, because air travel is now accessible to millions of low- and middle-income Americans, the #

number of people who travel on scheduled airlines in the United States has increased by 65 percent since deregulation. Last month almost 92 percent of air travelers flew on discount fares. Third, passengers enjoy a wider choice among airlines, and more frequent service. Three times as many passengers now travel in truly competitive markets--those served by three or more airlines--than did in 1978. Thanks to the development of competing nationwide hub and spoke networks, almost all passengers have a choice of carrier and routing in making domestic trips. For example, in the year ended June 30, 1990, 94% of all passenger trips were in markets where at least one competing airline carried five percent or more of the passengers, a far higher percentage than in pre hub-and-spoke days. The airline traveler has not been the only beneficiary; the number of airline jobs has grown by 75 percent too. Finally, economic deregulation has not diminished the safety oversight of the Federal Aviation Administration. As the National Transportation Safety Board confirmed a few weeks ago, accident and fatality rates have declined steadily since the 1960's. And 1990 was one of the safest years ever.

The current industry restructuring we are seeing is a continuation of the process that got underway in the late 1980's. It is in some ways the inevitable result of market forces unleashed by the Airline Deregulation Act of 1978. The reason so much seems to be happening today is that several factors have recently combined to accelerate the process.

First, the recent slowdown in the U.S. economy has reduced the demand for air travel. This sluggish growth has come at a time when airlines have added new planes and new services. This has contributed significantly to current carrier losses.

Second, the cost of jet fuel increased dramatically following Iraq's invasion of Kuwait in early August. Jet fuel is a major component of airline operating costs, second only to labor costs. Each one cent increase in the cost of a gallon of jet fuel imposes an extra $164 million in operating cost on the industry. Also, Kuwait was a significant factor in the supply of aviation jet fuel. I am gratified to see that prices have dropped dramatically from their November peak in the $1.40 range to the present levels in the low 70 cent range.

Third, airlines were given greater latitude under the free market principles of deregulation. Some airlines never quite adjusted to the rigors of the marketplace and suffered accordingly. Others took on massive and excessive debt, and have found it difficult to service that debt in a slow economy. To some degree airline management and the investment community are themselves responsible for the industry's current situation.

Fourth, most airlines have not been able to bring their labor costs under control. For example, the average salary for one carrier's pilots and copilots was $114,000 in 1989, not counting fringe benefits. The average salary for its maintenance workers was $51,000. Pilots and copilots industry-wide made five times what the average American worker earns. The average airline worker--including reservation agents, ticket clerks, janitors, and baggage handlers--makes approximately twice the national average wage.

These wages are not the product of a strictly free market. When pilots at one major airline average nearly twice what their colleagues earn at another airline, one might question whether something is seriously out of balance in the airline labor market.

Today's market is still distorted by vestiges of the era of regulation which allowed airlines to pass on uneconomically high costs. The industry still operates under outdated legislation from the 1930's--the Railway Labor Act--which, among other things, contains never-ending procedures to resolve disputes and allows for secondary boycotts.

I believe these distortions have created an unhealthy environment for the consumer. In contrast to other industries, airline managers and their employees appear to be oblivious to the long range consequence for the industry caused by an imbalance in power between labor and management. In the end, of course, the consumer loses. Either consumers must pay for high industry salaries through higher fares, or airlines will continue to hemorrhage financially.

Of one thing we are confident: consolidation is no grounds for panic. There may be fewer airlines in the 1990's than there were at the end of the 1980's. But even if this happens, we have every reason to believe that robust competition will continue. Under the system of competing nationwide hub and spoke networks which has developed under deregulation, existing carriers can serve most major markets in the nation on a one-stop basis. As a consequence competition should continue to thrive. Further, vigorous antitrust enforcement can be expected to prevent anticompetitive airline mergers.

The recent financial difficulties of the industry have produced almost desperate marketing strategies by some carriers and some incredible air fare bargains. But we know that unrealistically low prices are a bad bargain in the long run. Airlines must cover their costs or eventually go out of business. We should expect that as the industry consolidates further, which is likely, some of the lowest fares will disappear. When some of these bargains disappear, consumers should understand that the increase should not be blamed on deregulation. Had it not been for deregulation, fares would have been higher than they are now and service options lower. But, fares must cover airline costs in the long run and will still be lower then they would have been but for deregulation.

As the industry continues to restructure, the Department will take aggressive steps to sustain and enhance airline competition. Let me give you an overview of steps the Department intends to take to enhance competition in the airline industry, both domestically and in international markets.

Number one, the Department has announced a new policy which will significantly relax previous restrictions on foreign investment in U.S. airlines. This new approach is an acknowledgement of the changing nature of the airline industry, as the integration of domestic and international operations is moving the industry toward one of truly global airline companies. We believe it is important that our airlines be given greater access to foreign capital to enhance their competitiveness both domestically and internationally and allow them to participate in this globalization process.

At the same time, we don't believe it is necessary to change the current legislative limits on foreign ownership and control contained in Section 101(16) of the Federal Aviation Act. This section requires that the president and at least two-thirds of the board of directors and other managing officers of an air carrier be U.S. citizens and that at least 75 percent of the voting stock in the company be owned or controlled by U.S. citizens. Historically, the Department, and the Civil Aeronautics Board before it, have interpreted the statute to require that a carrier, in fact, be under the actual control of U.S. citizens. This has not changed. We have, however, reexamined and refined our application of the "control" test to ensure that it's fully consistent with today's realities. Our new policy will allow greater ownership of equity--up to 49 percent--while keeping foreign ownership of voting stock to the 25 percent statutory limit. We have also decided not to view debt as a foreign control issue, unless the loan agreement provides special rights to the foreign debt holder that imply control. We will also allow foreign membership on airline boards to reflect voting stock ownership--as long as it satisfies the statutory ceiling, and as long as representatives of foreign airlines do not take part in decisions affecting competition.

As I said, I am not persuaded that changes to the statutory limits are warranted at this time. There are legitimate arguments for maintaining the statutory citizenship requirements. There is a need for quick access to civilian airlift capacity in times of national emergency, as Operations Desert Shield and Desert Storm have shown. Also, in international aviation, landing rights are parceled out through narrowly drawn bilateral agreements. The U.S. has been the leader in opening up international markets to competition. If we are to maintain the leverage we need to open more foreign markets to U.S. carriers, we have to maintain oversight of the extent to which foreign carriers enjoy access to our market through investments.

Number two, in our exercise of our authority over international route awards and transfers, we intend to place even greater emphasis on safeguarding the competitiveness of U.S. carriers.

The availability of international routes is generally limited to rights negotiated in bilateral treaties and the Department must select among carriers to serve these limited entry markets. We intend to seek ways to streamline what is today a time-consuming, expensive and inefficient process of selecting carriers. We are also seeing a lively "secondary market" for international routes where carriers that have obtained international authority are seeking to sell established routes to other carriers. I believe the market can be an effective means of allocating international route authority, as long as the transactions are consistent with competition and the economic health of the U.S. airline industry. For example, Pan Am's sale of its Pacific routes to United in 1985, and Eastern's sale of its Latin American routes to American last year have produced a net dividend for the public. While we do not have any intension of "rubber-stamping" every transaction we review, we will be exploring ways to make our review of these transactions more efficient. Where there are no impediments to competition or where a transaction promises to enhance competition, our disposition is likely to be favorable.

Number three, we intend to take a close look at the policy of granting antitrust exemptions which permit airlines, both U.S. and foreign, to enter into agreements that fix the price of travel to and from the United States. There is a proceeding on this issue pending before the Department.

Number four, we are committed to removing barriers to entry in the airline industry. As I noted earlier, last year's aviation reauthorization legislation was critical to meeting this goal. It will enhance aviation capacity by allowing localities to raise money for expanding their airport facilities or building new ones. As called for by the legislation, we will soon propose a rule that will address the ability of new entrants to gain access to the four slot-controlled airports in the country. A proposed rule addressing ways to eliminate certain anti-competitive practices involving computer reservation systems should also issue soon.

Number five, we will explore the concept of allowing foreign carriers to compete in the U.S. market and U.S. carriers to compete in foreign markets. The U.S. and Canadian governments are due to begin negotiations in a couple of months toward the establishment of a truly open aviation regime between our two countries. During the course of those negotiations it has been agreed that the question of internal market access--called cabotage--would be addressed. This will be an important test of the cabotage proposition.

Number six, we put a policy in place last year to extend the benefits of domestic deregulation to international travel. One example is our cities program whereby underserved cities can receive air service to countries that have liberal aviation agreements with the United States, even if the bilateral agreement does not expressly call for this service. The Department just two weeks ago approved a KLM request to provide the only nonstop service to the continent of Europe from Minneapolis.

As the airline industry continues to restructure to meet the new realities of the changing global marketplace, the Department is committed to doing all it can to assure that the enormous benefits of deregulation are maintained in domestic markets and expanded to international markets. Airlines for their part must continue to look beyond our borders, whether by flying internationally themselves or by entering into agreements with foreign carriers. As for airline labor, it must look at the realities of the industry, and determine whether greater wage demands are in its own best interests. It is essential that airlines keep their costs under control. Failure to do so will ensure that no one wins: not employees, whose jobs will be placed at risk; not airlines, who may be forced out of business; and certainly not consumers, who will ultimately foot the bill through higher fares.

As the sad experience of Eastern Airlines demonstrates, there are no winners when labor and management do not work together.

We at the Department are optimistic that industry will weather the current storm and remain vigorously competitive. We will use the tools at our disposal to insure that that happens. I look forward to working with the Congress to achieve this goal.

Mr. Chairman, this completes my statement, and I would be pleased to respond to any questions you or members of the Committee may have.

TESTIMONY BEFORE
THE SUBCOMMITTEE ON AVIATION OF THE
HOUSE COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
OF
MR. RAYMOND J. VECCI
CHIEF EXECUTIVE OFFICER
OF
ALASKA AIRLINES, INC.
FEBRUARY 5, 1991

I am Raymond J. Vecci, Chief Executive Officer of Alaska Airlines, Inc., and am pleased to appear before the Aviation Subcommittee to address several of the important issues affecting the industry's financial condition and the adequacy of competition. A brief synopsis of Alaska's history prior to and since deregulation, including Alaska's continuous record of profitable operations, is attached as an appendix. My particular focus is on how the ever-increasing concentration within the industry is making it far more difficult for the few remaining non-mega-carriers, of which Alaska is one, to remain effective competitors.

Alaska comes here today well aware of the fact that it is a small carrier--even though its 1990 revenues, including those of its affiliated regional carrier, exceeded $1 billion. Alaska also knows that being only 1/13 the size of the mega-carriers means that Alaska does not have the same purchasing and marketing power. We pay more than do the mega-carries for many of the items and services we purchase.

On the marketing side, Alaska cannot match the nationwide override commission programs of the mega-carriers. Those are based on establishing lucrative volume incentive thresholds for the national travel agencies which very effectively cause those agencies to direct the vast majority of their nationwide business to one or two principal carriers in order to meet the high incentive thresholds. It can fairly be said that such override commissions are contrary to the public interest. These commissions do not stimulate additional travel because little, if any, of the commission filters back to the consumer, unlike discount fares.

Similarly, the marketing power of the mega-carriers' frequent flyer programs is such that whatever program we offer has to cost more per passenger in order to be competitively effective. All of these costs and marketing disadvantages are difficult challenges and we fight them every day. But there is no reason in the world why, in addition to these burdens, which have so disproportionately affected the smaller carriers, we should also be required to cope with regulatory inaction or misguided regulatory policy. The smaller carriers have dwindled in number to essentially those carriers which appear at this table.

The industry's problems and how the smaller carriers stand to be affected cannot await more temporizing. Solutions must be found if there is to be a successful rebirth of competition.

The topics I address are:

1. How the Department's continued unwillingness to place any restraints on the level of computer reservation system booking fees is forcing the smaller carriers to continue their massive revenue transfers to the mega-carriers; and
2. The relaxation of the foreign ownership and foreign control prohibitions along with granting cabotage rights to foreign carriers requires urgent further study before it is permitted to proliferate.

I. The Department's Continued Inaction With Respect to the Computer Reservation System Issue Must Be Corrected

The computer reservation system problem first surfaced at the Department of Justice in 1982 and has been studied and restudied by the Department of Justice, the former Civil Aeronautics Board, the Government Accounting Office, other committees of Congress and by a number of U.S. courts. In spite of all that study and the implementation in 1984 by the Civil Aeronautics Board of the so-called "CRS Rule" prohibiting overt carrier-specific display bias and mandating uniform booking fees, nothing of substance has changed. Non-CRS vendor-carriers and, to a lesser extent, the smaller CRS vendor-carriers, are still transferring hundreds of millions of dollars in revenue each year to the principal CRS vendor-carriers--American and United. The present $2.25 booking fee is at least twice the level of any reasonably objective estimate of the properly allocable costs incurred by the two principal CRS vendor-carriers in providing reservations services. The Department of Transportation's 1988 CRS Report, which probably set new standards for understatement, found that the booking fees charged by Sabre and Apollo are no less than 200% of their allocable costs.[1]

Those same hundreds of millions of dollars in revenues--if the non-CRS vendor-carriers were not compelled to hand them over to the principal CRS vendor-carriers--could and would be used to acquire new aircraft, open new stations, operate more flights and carry more passengers. But instead, this massive and highly anti-competitive subsidy being paid by the non-CRS vendor-carriers to the CRS vendor-carriers only fuels their already considerable market power and the ever increasing disparity in size between those carriers and the smaller non-CRS vendor-carriers, such as Alaska.[2] Although there has been much previous

---

1/ Study of Computer Airline Reservations Systems, May 1988, at 110.

2/ The Department of Transportation's CRS Report estimates that American's and United's cash flows were increased by almost $600 million dollars in 1989 because of the level of booking fees charged by those CRS vendor-carriers. CRS Report, supra at 79.

discussion about CRS divestiture, that remedy appears to be on the back-burner. Indeed, whatever proposed changes the Department was going to announce in the form of a Notice of Proposed Ruling are understood to be contained in a voluminous report which has been bottled up by the Office of Management and Budget for a number of months. Although Alaska has not seen that report, we understand that OMB's objections are apparently premised on the notion that one or more of the Department's recommendations are "overly regulatory." That impasse should be quickly brought to an end and the issues should be explored thoroughly by the Subcommittee. OMB should not be permitted to continue acting as a roadblock to any improvement, however minimal, in the CRS problem.

The most serious and as yet unresolved problem is the level of the CRS booking fees which the non-CRS vendor-carriers must pay to principally American and United. Even if the Department, as we assume to be the case, is unwilling to consider regulating booking fees, there must be some outside voice that can decide objectively whether those fees, and what are undoubtedly going to be further increases, are reasonably related to Sabre's and Apollo's costs of providing reservations services.

The solution which Alaska would recommend is that Congress, by statute, or the Department, by regulation, mandate that any disputes about the level of CRS booking fees be referred for mandatory arbitration at the request of either the CRS vendor-carrier or the non-CRS vendor-carrier. Although the first such arbitration proceeding would likely be rather complex and may even break new ground, the strong likelihood is that the guidance gleaned from that decision would have the salutory effect of serving as a brake on further unwarranted CRS booking fee increases as well as any unwarranted expectations by the non-CRS vendor-carriers about what a reasonable fee for those services would be.

We are aware that this solution has been proposed in the past and has died for lack of consensus. Alaska believes that it is time for the issue to once again be raised. Allowing the status quo to remain is unacceptable. But for the Department's pending review of the CRS Rule, it is likely that the CRS vendor-carriers would have raised their fees beyond even their current levels. To appreciate the market power the CRS plays in the hands of the CRS vendor-carriers, it need only be recalled that implementation of the CRS Rule in November 1984 was accompanied by a 600% increase in the average booking fee then being paid by the non-CRS vendor-carriers from approximately 30 cents per booking to $1.85. Yet not one of the non-CRS vendor-carriers gave more than momentary consideration to not continuing to participate in the CRSs and paying the 600% price increase. That fact alone speaks volumes about the market power of the two principal CRSs, which has shown no size of abating. In fact, there have been a number of recent articles about how the survival of the smallest of the four remaining CRSs is threatened and there is very little expectation that that system will remain.

II. The Likely Effect of the Department's Decision To Liberalize the Foreign Ownership and Control Restrictions Requires Further Evaluation

Before even addressing the substance of the Department's recent decision to significantly liberalize the amount of non-voting equity and debt securities which a foreign investor may own in a U.S. carrier, I would be remiss if I did not express objection to the extraordinarily expedited manner in which that very important decision was made. As to the substance of that issue, I find it extremely difficult to believe that a liberalization of the foreign ownership restrictions will prove to be a panacea as others seem to be suggesting. Well-heeled foreign investors are far more likely to invest in the stronger mega-carriers than in the weaker carriers in the industry. I cannot believe that SAS, for example, would make the same decision today to invest in Continental if it then knew about Continental's present situation.

My principal concern is that liberalization of the foreign ownership and control restrictions should only take place if there is a high degree of certainty that there will be clear and demonstrable public benefits for the industry as a whole as well as an improvement in competition. I am aware of no empirical evidence that will support a conclusion one way or the other. There is surely none in the Department's recent decision.

Until a carefully considered objective analysis has been completed, I would suggest that the Department be advised that there are to be no further instances where increased foreign ownership and control will be permitted until Congress has acted. If legislation is necessary to make absolutely certain that there are no further such instances, then I would be in favor of such legislation until there has been a thorough evaluation of the ramifications of a change in the foreign ownership and control restrictions.

Among the questions that such an evaluation must address are:

1. Should an increase in foreign investment be limited to those investors whose homeland countries have granted significant and clearly defined benefits to U.S. carriers?
2. Should any liberalization of the foreign ownership issue await Congressional action on whether to also liberalize the current cabotage restriction?

I do not see how there can be an informed decision about liberalizing the foreign ownership restrictions without contemporaneous consideration of the cabotage issue. One can simply not allow a foreign investor to purchase most of a U.S. carrier's non-voting equity and debt as well as 25 percent of that carrier's voting securities and ignore the real world impact of such a substantial investment. A foreign investor in such an instance is buying access to, and profits from, any and all of our principal domestic markets. By any other name, that is cabotage without a change in the logo on the airplane. For that reason, until the statutory cabotage prohibition is changed, which is a matter for Congress and Congress alone to decide, this Subcommittee must take whatever action is necessary to prohibit any further indirect grants of cabotage through the guise of liberalization of foreign ownership and control restrictions.

Please understand that I am not irrevocably committed to a blanket cabotage prohibition or to perpetuation of the current foreign ownership and control restrictions. But I do not want to see a decision on these important questions made on the basis of one carrier's situation or even on the basis that a particular foreign country permits unrestricted reciprocal investment by U.S. investors.

Once again, whatever the Subcommittee finally decides to do, the Subcommittee should put forth a clear directive to the Department that there are to be no further instances where liberalized foreign investment or foreign control is permitted, until Congress has concluded the thorough deliberation which this issue deserves.

APPENDIX

Prior to 1978, Alaska's entire route system was restricted to routes between Seattle and various points in the State of Alaska. On each and every occasion prior to deregulation that Alaska had sought to gain entry to routes between Seattle and other points in the "lower 48," those routes were awarded to other carriers. Since deregulation, Alaska has pursued a cautious pattern of expansion and Alaska now serves every major city in the states of California, Oregon, Arizona, Idaho, as well as four cities in Mexico. Alaska's parent company owns Horizon Air, a sizeable Pacific Northwest regional carrier which serves more than 40 cities in the states of Washington, Oregon, Idaho, Montana and Utah--plus two cities in Canada. The combined revenues of Alaska and Horizon were just in excess of $1 billion in 1990. Alaska operates approximately 60 jet aircraft while Horizon Air's fleet consists of more than 50 F-28, Dash-8 and Metroliner aircraft. Alaska can also state proudly that it has managed to earn a profit in each year since deregulation.

THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

WEDNESDAY, FEBRUARY 6, 1991

House of Representatives,
Subcommittee on Aviation,
Committee on Public Works and Transportation,
Washington, DC.

The subcommittee met, pursuant to recess, at 9:30 a.m. in room 2167, Rayburn House Office Building, Hon. James L. Oberstar (chairman of the subcommittee) presiding.

Mr. **Oberstar**. Today we resume our hearings on the financial conditions of the airline industry and the status of competition, having had very stimulating and lively, vigorous participation yesterday by a wide range of witnesses, starting with the Secretary of Transportation, and some very revealing insights into problems and some solutions recommended—a wide range of approaches to the industry's current difficulties in the hope of retaining and stimulating competition.

This morning we will begin with our colleague, my neighbor to the west from the great State of North Dakota, Congressman Byron Dorgan, a member of the House Ways and Means Committee.

Welcome to our hearing. Thank you for being our leadoff witness this morning.

TESTIMONY OF HON. BYRON L. DORGAN, A REPRESENTATIVE IN CONGRESS FROM NORTH DAKOTA

Mr. **Dorgan**. Mr. Chairman, thank you very much. I will submit a full statement for the record. I apologize that it won't be here for a few more minutes, but I would like, if you will, to make that statement a part of the record.

Mr. **Oberstar**. Without objection, your full statement will appear in the record, and you may speak from the fullness of knowledge, as you are.

Mr. **Dorgan**. Mr. Chairman, thank you very much, and I really appreciate you holding these hearings.

I must tell you that I don't come today as a witness to testify as an expert on the finances of airline companies or the financial condition of the airline industry, but I did want to take the opportunity in the context of these hearings to provide you with some thoughts from someone who comes from a rural part of the country and someone who, on the Ways and Means Committee, has had an active interest in speculation and the orgy of debt that's been placed on corporations, including airlines, in the 1980s. So I wanted to talk about those issues with you.

We have been through deregulation of the airlines, and some think it's a resounding success; others think it's a tragic failure. I was chairman of the State's Airline Commission in North Dakota for a number of years before I came to Congress. We are not a State that has a significant traffic load, we don't have airlines fighting with each other to see who might be able to come in and serve North Dakota. We are a sparsely populated area of the country, we rely on air transportation, value it highly, think it's very important to our economy, but as you know, we are served largely on east-west routes by Northwest Airlines and then to a lesser extent by a couple of other carriers, using principally Denver as a hub, but our principal service in North Dakota is Northwest Airlines. My testimony is not a criticism of Northwest Airlines. I think Northwest is a fine company that's done well, served North Dakota well, and I don't come here to criticize them. I do, however, think as we look at deregulation, we need to ask ourselves "Has this worked well?"

Clearly, in some parts of the country it has worked very well. If you are traveling from Chicago to Los Angeles and live in one of those cities and have needs for commerce moving back and forth, you can probably find some awfully good fares. There is good competition. Gosh, as a consumer, you've got lots of alternatives, and it's a good deal. Deregulation means easy entry, easy exit, highly competitive fares, not a lot of structure coming from the CAB out here as it used to be, telling you what kind of fares you had to have—you know, it's a good deal. But if you live in Bismark, North Dakota, ask the same question. Is it a good deal? Do you have the same competitive fares? Do you have the same opportunity, the same juices of competition that provide opportunities for consumers? The answer is no, of course not. So it's not quite as good a deal for people in the less populated areas of the country as it has been for those in the heavily populated areas.

Now, Secretary Skinner said:

> Consolidation is no grounds for panic. There may well be fewer airlines in the 1990s than there were at the end of the 1980s, but even if this happens, we have every reason to believe that robust competition will continue.

Well, I taught economics in college and have almost overcome that experience completely, but I know enough from what I remember of that experience that if you have more consolidations and fewer major airlines, it is not going to enhance robust competition. That defies logic. We ought to be concerned in this era of deregulation about the number of carriers available, about the concentration and what concentration does to competition. It's our job to be concerned about that, and it's the Secretary's job to be concerned about that, and to sort of brush it off as kind of an incidental issue is, I think, a very serious mistake.

Now, you know what's happened in recent years. We have been in this country in a kind of speculative binge, loading up corporations with debts so that some sharks can take advantage of taking assets apart and making big money. Well, the sharks would issue junk bonds, go after targets, take the target apart, sell it, and make a lot of money. It weakened the economy, in my judgment; it didn't do anything good for the country; it made a few people rich; and now it's made a lot of people poor as the junk bonds collapse. What happened at the end of that process is that airlines began to be put into that same kind of play, and the question I want to raise with you today is should the Secretary and Congress have basically stood by and not acted, and should we continue to take that same posture with respect to the speculation that probably will continue in this industry?

Continental's in bankruptcy protection, as I understand it; Eastern doesn't exist anymore, its assets will be liquidated; TWA, I believe, defaulted on its bonds a few days ago; Northwest Airlines was subject to an LBO and issued junk debt instead of junk bond and loaded its balance sheet up with debt—you know, the list goes on. United Airlines was in play it seemed like every other month with a new group of players. The question is who's going to load United with debt in order to convert that debt to some short term income for some barracudas out there?

You know, that is not healthy for the airline industry in this country, and the reason is very simple. The airline industry is extraordinarily sensitive to economic movements in this country. Economic downturns mean that the first to feel an economic downturn will be the airline industry. It's a leading economic indicator. One of the first areas that business will cut back is business travel on airlines. It's why they experience the first tinge of economic downturn in this country. To load an industry that sensitive to economic downturn with heavy debt is crazy.

Now, I had one of the biggest LBO people in the country sit beside me at a breakfast one day, and he said to me—we were talking about airlines and hostile takeovers, because this guy is involved in all kinds of hostile takeovers, and I've been a big opponent of his in Congress—and we talked about airlines, and he said:

> I'll tell you something. I would never get involved in an LBO or a hostile takeover with airlines, because that's a unique industry subject to such sensitive movements of the economy, and you can't predict whether you're going to be able to generate the income to pay your debt service.

He said, "I wouldn't think of being involved in it." A week later, he put in a bid in a hostile takeover move on an airline. He didn't get it, but, of course, that not only described his voracity, but it also described, it seems to me, in a candid moment what even those inside the speculative movement understand about the nature of airlines.

I raise this question today because I don't think the Secretary and I don't think we in Congress have paid quite as much attention as we should to what's happening to major carriers in this country and to what will happen if we don't decide that we want to foster and maintain a network of financially healthy major airline companies free from the waves of speculative activity on Wall Street and around the country and free from natural economic concentration that may or may not result if we don't get involved and the Secretary doesn't get involved in caring about concentration.

And let me tell you I introduced legislation in Congress in the last session and intend to reintroduce it dealing with the question of hostile takeovers or LBOs in the airline industry, attempting to provide some impediment in that area of activity.

And let me finally make one other comment, Mr. Chairman. Even as we're not speaking of this specifically, I want to put in a word about essential air service. Essential air service was part of a promise made during deregulation, and that promise has since been reauthorized and renewed, but the promise is not as helpful to small communities if each year in the appropriations process we keep those small carriers that serve in the EAS cities on the end of a string, dangling day by day and month by month, wondering whether in this Congress they'll actually get appropriated money and if they get it, how much it will be, and then not only how much, but when will they get it. And those airline carriers, many of whom operate with thin finances, are not able to very easily sleep at night wondering if they'll get money and how much and when. We need to, I think, respond better to those small communities who are granted that promise of essential air service under today's conditions.

Mr. Chairman, I would like to submit the full statement for the record, but I did want to make those comments about concentration and debt with respect to major airline carriers, and I appreciate your giving me the opportunity to do that.

Mr. OBERSTAR. Thank you very much, Byron. We really appreciate your continued advocacy. You have come repeatedly before this committee and before the Investigations and Oversight Subcommittee, when I chaired that one with Mr. Clinger's support, on aviation issues and shared with us your experience, your knowledge, your personal pain with many of the problems that all of us seem to share from time to time.

North Dakota, as you've said, though it does not harbor a hub, is nonetheless a center of aviation activity with its splendid University of North Dakota Aviation Program and many other initiatives that it has developed that make North Dakota a leader Nationwide in aviation.

I hear you on essential air service, and we heard you last year, and with your vote and support we passed legislation to deal with essential air service to make funding essential air service a firm commitment by the Federal Government, an entitlement, if you will, that comes out of the Aviation Trust Fund. Now, Mr. Clinger and I worked on this thing, but Mr. Hammerschmidt, the senior Republican on the full Public Works Committee, and I have developed a partnership on that issue going back to the early days of deregulation—1978 or 1979—and without that provision, I doubt if the deregulation bill would have gotten out of this committee.

And the commitment to essential air service seems to have declined over a period of time and zeroed out of the budget, but you'll be happy to know, if you haven't already researched it, that the President's budget for fiscal year 1992 includes $38 million for essential air service. That is an increase over the current fiscal year, it is the highest amount requested for EAS in over a decade, and it is an indication that our work last year on the aviation reauthorization legislation—the whole Airport Improvement Program, Facilities and Equipment, and Operations and Maintenance programs, the passenger facility charge legislation and the noise legislation—bore fruit in the context of the budget agreement, and the result, of course, is the legislation that was signed into law and the commitment carried through by the President.

Yesterday we had extensive testimony from a wide range of witnesses addressing the consolidation questions that you talked about, the debt-loading, and I would urge you to pick up a copy of GAO's testimony as you leave this morning, because there is a whole section in that testimony showing the progression of debt by a major airline company over the past decade, at least from the beginning of the 1980s through until this year. It is very instructive, and when I reflect back on yesterday's testimony and a parade of airline witnesses who bemoaned the current financial conditions of the airline industry and asked for relief from all of the difficulties they had, among them were those who intentionally shot themselves in the foot with big debt load. Now they're saying—you know, it's like the guy on the corner with the tin cup—"Can you spare me a dime?" Except in this case it's more than dimes; it's billions.

And we may be in the odd position of having to help people out of bad decisions that they made that seemed good at the time, like your friend who said "don't get into a Leveraged Buy Out with an airline," and then did. It looked good at the time, and if the economy had all done well, maybe they could have survived without those difficulties, but hit by the triple whammy of more than doubling of jet fuel, a major national economic recession, and their need to have high cash flow to meet their debt payments, they're just dropping like flies.

In the last Congress, we did deal with the problem of LBOs. You voted for the legislation. You were a good advocate for it. In fact, you had some ideas to strengthen it in ways that we thought might be "veto bait," but it never got out of the Senate. It passed the House by an almost three-to-one vote, and it never got out of the Senate. At yesterday's hearing when I questioned witnesses about this subject of LBOs, it seemed that LBOs are yesterday's problem. There are different problems today. Passing legislation to prevent LBOs in the future or slow them down or restrain them is not the problem we need to address, because whatever could be put in play was put in play, and there are different problems facing the industry now.

I'll conclude on this point and ask for others' comments. One of the proposed solutions to the industry's difficulties—and by the way, to deal with the question of consolidation and stimulating and sustaining competition, GAO has a number of recommendations, and we had many similar ones surface yesterday, and the committee will be addressing those, and we'll be looking to fashion some legislation—but one of the suggestions was—in fact, it was my suggestion—that the Administration suspend the 2 percent ticket tax that they stuck into the Budget Reconciliation Act which is not part of our overall agreement. We did a number of things to increase money going into airport improvements—to draw down the reserve in the trust fund, which would have been at $7.6 billion last year had we not done this, and the passenger facility charge to generate additional monies—so that we wouldn't have to have a ticket tax for maybe another five, seven, eight years, depending on how that money flows.

There's no reason that the Administration couldn't come forward with a suspension that might pose some budget problems, but goodness knows, they've found ways to get around those difficulties in the past, and there's no reason they couldn't find a way to get around a little 2 percent that might help the airlines.

Give that some thought from your perch on the Ways and Means Committee.

Mr. Clinger?

Mr. CLINGER. I just would like to thank Congressman Dorgan for his testimony, underscore your hope that perhaps the Ways and Means Committee might consider that as a help at this point to the embattled airline industry, and also to totally endorse your support for EAS, which I think you can sense that the members of this committee have been very supportive of, and we're all delighted that the President's budget does include full funding for EAS for the first time in a long, long time, which I think is a step in the right direction.

Thank you very much for appearing today.

Mr. OBERSTAR. Mr. Laughlin?

Mr. LAUGHLIN. I don't have anything.

Mr. OBERSTAR. Mr. Boehlert?

Mr. BOEHLERT. I would just like to ask my colleague if he would give us an answer to the question you posed about whether the restriction on foreign investment should be lifted or elevated to the 49 percent—I mean, that's the central question of the whole hearing. Do you have a feel for it?

Mr. DORGAN. No, I don't. I did pose the question, and I think it is an important question. But I guess I would probably want more background of the type that you have on this committee before I made a recommendation on the foreign investment question. I defer to your judgment on that.

Mr. BOEHLERT. All right. Thank you very much.

Mr. OBERSTAR. Mr. Swett?

Mr. SWETT. I'd like to take this opportunity first to thank you, Mr. Chairman, for the opportunity to serve on the Aviation Subcommittee. This is an important discussion that I think we're having regarding the competitive nature of our aviation industry, and I think that you have clearly and articulately identified the two major problems that the industry is facing.

I agree that we have to be extremely vigilant in ensuring that the industry remain competitive and that that remain competitive over all routes in the United States. I, too, share a concern, as you have so well stated, that by reducing the number of carriers we are going to impact on that competitive nature of the marketplace. It is my hope that through the discussions on this subcommittee we might come to an understanding that there is a minimum number of carriers and a minimum number of routes available that will maintain a healthy, competitive marketplace in the aviation industry.

I think more importantly, as my good colleague pointed out, that the central question has to do with capitalization of the industry and whether or not we have the funds here in this country to secure the capital necessary to avoid the LBO situation that you so rightly spoke of earlier. And I think that as we look at this issue it's going to be extremely important to evaluate if in fact we can capitalize the industry to the extent that we will not encumber it with unproductive debt. I believe that it's necessary that that take place. I think that that is going to be far more impacting on the competitive nature of this industry in the future, and I think that it's a question that is going to need to be examined closely and ultimately resolved in the near term if we are to save the very competitive nature that we speak of today.

I appreciate your testimony, I thank you for appearing before the subcommittee, and I look forward to hearing your thoughts as you consider drawing upon the distant experience of your economic background, bringing that to the forefront and enabling me and my colleagues to better decide on the course of the industry at this point in time. Thank you very much.

Mr. **Dorgan**. Mr. Swett, thank you. Let me just finally say that I don't believe the question of LBOs or hostile takeovers is behind us. I think that there are still people out there in cash positions who have an inclination to want to pursue these who will pick at economic carcasses when we're passed this question of high jet fuel and other things, and we will have a potential problem, and I would like to see some leadership both from Congress and from the Secretary.

And I do commend you, Mr. Chairman, for your leadership last year on what we did pass. As you know, I felt we should be even more assertive and stronger in that area, but you might well have been right that it could have been veto bait.

Let me make one other final comment. I didn't mention airline fares, and part of the notion of competition is manifested by fares. I've got an uncle in a small town of 300 people who is trying to sell a three-bedroom house for less money than a round-trip coach fare between Bismark, North Dakota, and Washington, DC, if you don't buy it seven days in advance and don't stay over a Saturday night. The fact is these fares have gone just crazy, especially in areas where you don't have robust competition, and that also will affect the question of how many people are airlines going to carry in the future. The question is at what price will people move on airline? If fares get too high, they lose part of their market.

Mr. **Oberstar**. And if we get fewer airlines, those fares will undoubtedly go higher as concentration occurs in the industry, as GAO's testimony over the past two years has indicated and the GAO studies have indicated on concentration at hubs. We may well come to a point where, like some small towns in northern Minnesota, the only way to get there is to be born there. [Laughter.]

Mr. **Dorgan**. It's a good point, and we know a lot about fewer airlines in rural areas of the country, because we don't have a lot of airlines, and the result is we don't have a lot of competition, and we understand full well what that results in by way of fares. If you don't have robust fare competition, consumers are not able to take advantage of the same bargains that consumers now do in urban areas of the country.

Mr. Chairman, thank you very much.

Mr. **Oberstar**. Thank you very much for your thoughtful presentation this morning. We will look forward to working with you and the Ways and Means Committee perhaps as elements of this drama unfold.

[Mr. Dorgan's prepared statement follows:]

testimony of

BYRON L. DORGAN of NORTH DAKOTA

before the

AVIATION SUBCOMMITTEE

PUBLIC WORKS & TRANSPORTATION COMMITTEE

U.S. HOUSE OF REPRESENTATIVES

concerning

CONDITION OF HIGHLY LEVERAGED AIRLINES

February 6, 1991

Mr. Chairman, I came here today to encourage your subcommittee to take charge in the business of leveraged buyouts in the airline industry.

Our secretary of transportation, who heads the department charged with supervising the airline industry and watching out for the public interest, apparently has little concern about speculative and high-risk schemes that run our major airlines into the ground.

The secretary said recently: "Consolidation is no grounds for panic. There may well be fewer major airlines in the 1990s ... But even if this happens, we have every reason to believe that robust competition will continue."

Considering who they come from, I think those words are careless, and they should not be comforting to those who like good airline services.

I also wonder if, having endured the disruptions and adjustments to deregulation, we are going to reap the higher level of competition that deregulation is supposed to foster, or if we are going to return to the oligarchy we had before deregulation. Consolidation is certainly not in the direction of competition.

Two years ago I introduced legislation asking the Congress to take charge in an area of leveraged buyouts and high-risk, big-debt ventures in the airlines. At that time, the recent buyout of TWA had more than doubled that company's debt, and a leveraged buyout of Northwest was waiting in the wings.

I am back. Some of our airlines as deeply imbedded in debt and have dropped into bankruptcy. We have watched investment shenanigans destroy Eastern Airlines. TWA defaulted on its bonds last week in order to preserve enough cash to continue operating.

Financial trouble for the highly leveraged airlines is certainly not a surprise. We have allowed financial sharks to feed on the airlines, loading them with debt, propping them up on junk bonds, and turning them into anemic giants. We have to expect airlines to fail under those conditions. An airline with most of its income dedicated to paying interest on high-yield bonds will not survive a sustained economic downturn.

So far, our Department of Transportation has shown little interest in imposing sanity upon airline ownership schemes. So, I am asking you to move quickly in that arena. Let's require responsible investment and ownership arrangements for an essential service such as air transportation.

We have a responsibility to do so.

Airline regulation does not have to be a monolithic creature that moves all in one direction or the other — all toward regulation or all toward deregulation. Done properly, regulation moves in to safeguard the public interest when abuses arise, and recedes in areas where the controls unnecessarily impede economic growth, competition, or other positive aspects of the regulated sectors.

Currently, for example, I understand you may consider loosening the restriction on foreign investment in U.S. airlines. The question is whether that restriction, now a half-century old, is a meaningful protection of the public interest, or an unnecessary roadblock to healthy growth and maintenance of the domestic airline sector.

We have watched a reordering of the airlines in the past decade. In the first 40 years of airline regulation, we allowed the Civil Aeronautics Board to preside over an oligarchy of protected airlines. In the 1980s we experimented with competition in that sector, and reaped some benefits in opening air service to direct competition. We have had a difficult time in my region, struggling to maintain service to small cities during the decade-long scramble for market share among airlines. Still, we have been able to maintain a reasonable level of service, and recent studies show that our average fares, adjusted for inflation, have actually declined in many locations since the deregulation experiment began.

It may be that we will, in fact, see a new round of consolidation of airlines. Up until now it seems to be our national policy to allow high-risk schemes to devour our airline companies.

If we do see further consolidation, it will be at the expense of competition within the industry. That would be unfortunate and a bit ironic because, you will recall, a greater level of competition was supposed to be the accomplishment of the 1980s, the foremost benefit of deregulation.

However, if we are unavoidably on the road to more consolidation, let us at least install some guard rails to discourage LBO kings and fast buck operators from derailing our major carriers. We don't have to consign major carriers to a financial crash whenever we have a slowdown in passenger volume.

Mr. **Oberstar.** Our next witness is Mr. Ken Mead and his associates from the General Accounting Office. Mr. Mead is the Director for Transportation Issues, Resources, Community and Economic Development Division at GAO; a frequent witness before this committee, a frequent contributor to the fuller understanding of aviation issues and the problems in the industry.

The GAO—and I think Mr. Clinger would concur with me about the years we worked on the Investigations and Oversight Subcommittee—has saved the Federal Government and the taxpayers hundreds of millions of dollars a year in sound and thoughtful recommendations they have made for improvement in Government efficiency and operations and the contributions they have made to this and to other committees. But in this one we know your work, and we're very appreciative.

You've produced an extensive and detailed document which will be included in the record in full and any supplements that are not yet apparent that you may wish to include. I would encourage GAO to publish this document as an official GAO blue book for wider distribution, it is so well researched and thoughtfully prepared and substantive. Perhaps I shall have to write to the Comptroller General to encourage him to do so, but I think it is a very significant document.

Now, if I go any further, I'll give your testimony, so let me stop and let you proceed.

TESTIMONY OF KENNETH M. MEAD, DIRECTOR, TRANSPORTATION ISSUES, RESOURCES, COMMUNITY AND ECONOMIC DEVELOPMENT DIVISION, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY JAY CHERLOW, FRANK MULVEY, JACK WELLS, AND DOLORES PARRETT

Mr. **Mead.** Thank you, Mr. Chairman. We always appreciate it when chairmen don't summarize our statement in their opening statement.

I would like to greatly abbreviate our prepared statement this morning, and first I would like to introduce my colleagues.

On my far left is Jay Cherlow. I don't believe he has appeared before the subcommittee before. He's here because of experience with the Conrail, Chrysler, New York City and Lockheed assistance programs. We thought that there might be some interest in that down the road perhaps.

Frank Mulvey, on my left, is our Assistant Director for Competition and has been with these issues for several years. The rest of our team, Jack Wells and Dolores Parrett, all have been involved with airline industry issues for several years.

I'd like to group the points I have to make today into five areas. The first would be short and long term problems in this industry; second is the impact on competition if some firms fail; third is some actions that could be considered to promote both competition and financial health; fourth, some thoughts on the international issue; and finally, other options that we think the subcommittee may be called upon to consider that we think are premature and in fact could be counterproductive.

Mr. Chairman, the industry has developed some serious long term problems that weaken the financial position and survival of some carriers. Chief among these are, one, high levels of debt, and two, operating and marketing practices that some carriers have adopted that in fact prevent others from competing effectively. More recently, the industry has been hit by two short term problems: The recession, which we certainly hope is short term, and the Persian Gulf crisis, which, of course, has raised fuel prices. The short term problems have merely exacerbated the financial weaknesses that have been building up over the past decade. By this I mean that the short term problems simply bring matters to a head sooner than otherwise would have been the case.

To share with you some figures, between 1980 and 1989 long term debt as a percentage of capitalization rose from 62 percent to 273 percent at Pan Am, from 62 percent to 115 percent at Trans World, from 62 percent to 96 percent at Continental. Eastern's debt rose to 473 percent of capitalization before it went bankrupt. Debt levels at America West and Midway rose to 85 percent and 78 percent, respectively, while other carriers—American, United, U.S. Air, Delta, Southwest and Northwest—kept their debt levels below 60 percent. American Airlines in particular reduced its debt level during the period to 34 percent.

At the same time, operating and marketing practices used in this industry make it more difficult for some carriers to compete. Airport access is limited by the practice of leasing gates to airlines on long term, exclusive use leases—these are for 10, 20, 30, sometimes more years—and by majority-in-interest clauses. Our analysis showed that carriers charge significantly higher fares on routes to airports where they control a large portion of the gates. Last October Congress passed legislation authorizing airports to levy passenger facility charges. This should give the airports a source of revenues independent of the airlines, and we think it will help. It's an important step.

Our analysis also shows that FAA slot controls lead to higher fares on slot-controlled routes, and while these slots certainly enhance the revenues of carriers who have established positions at these airport, they make it very difficult for the carriers on the out to compete.

Some airline marketing practices also limit competition. Over two years ago, we testified before this subcommittee on the competitive impacts of computerized reservation systems. While most of the major carriers are now part owners of CRSs, and that's a change from when we were here two years ago, most of the benefits of these systems go to the majority owners of the two dominant systems—American and United. We calculated that the lack of effective competition in this industry allows American and United to each receive over $300 million per year in excess of the cost of the service provided, including a provision for reasonable profit. Frequent flyer plans, however popular they may be, and code-sharing arrangements also discourage competition.

I think you heard yesterday about airline industry profitability. I'm sure you heard that they're headed for what appears to be a loss of over $2 billion in 1990. Now the recent—and I underscore recent—decline in profitability is due primarily to the decline in the health of the economy and the rise in the price of fuel. A word about where we stand on fuel today. The cost of jet fuel rose from 56 cents per gallon in July to a peak of about $1.11 in October, pushing average overall operating costs up by a little over 10 percent. Since then the fuel costs have fallen from the $1.11 mark to about 70 cents, and we expect that they will fall further. That assumes, of course, that the Persian Gulf situation doesn't go on for an extended period of time.

Now, as profits have declined, it's important to point out that carriers have been less able to service their debt. It's not just a matter of servicing debt. The fact is that earnings in the third quarter of 1990 were less than the interest charges alone for six of the 11 major carriers, and almost certainly it got worse during the fourth quarter.

The industry also faces substantial investment demands, and I did not hear these mentioned extensively in yesterday's testimony, but these investment demands are essential for meeting compelling safety and noise abatement objectives. They include FAA's recent airworthiness directives for repairing the aging aircraft fleet, which comprise well over 25 percent of the U.S. fleet. We in fact have the oldest commercial airline fleet in the world. And, of course, there is the Stage 3 noise requirement.

A second point I'd like to make is that if several airlines do fail to survive the recession, competition could be adversely affected. The four carriers in the weakest financial condition collectively carried about 28 to 30 percent of the industry's traffic last year. Now, if these carriers cease operations, market shares of the remaining carriers can, of course, be expected to rise. Our analysis shows that increasing a carrier's market share on a route from 10 percent to 20 percent can result in increases in fares by nearly 9 percent.

It's been suggested, Mr. Chairman, that the survival of four or five carriers would be enough to achieve competition. This would be true if several carriers served most routes, but about 76 percent of all passengers fly on routes served by three or fewer carriers, and 45 percent fly on routes served by only one or two carriers. On these routes, then, the loss of a single carrier could have a serious adverse affect. The loss of competition when a carrier ceases operations can be reduced if DOT and the Department of Justice scrutinize sales of gates, slots and international routes to ensure that those sales do not result in avoidable losses of competition.

I think the subcommittee will recall that DOT did not do this in the case of mergers and acquisitions in the 1985, 1986, and 1987 period. But it seems to have changed since, and both DOT and Justice have made very clear that they're currently monitoring asset sales by Eastern. The prospective sale of Eastern's gates in Atlanta to Delta Airlines, for example—Delta already dominates routes from Atlanta. That would significantly reduce competition in the Atlanta market. I might also point out that in the Atlanta market fares since deregulation have already increased more on average than in any other hub market.

The third point, Mr. Chairman, is that the potential reduction in competition that could result if several carriers cease operations points to the need to take further action to enhance the industry's competitive balance. In our previous testimony before this committee, we discussed a number of policy initiatives to promote competition. We think the current situation lends much greater urgency to their consideration.

The Government's interest in the survival of threatened carriers is primarily one of ensuring that enough carriers survive to provide effective competition. Let me put it another way. Ultimately this can be achieved only by keeping the industry open to market entry by ensuring that a level playing field exists. While policies to promote competition might well reduce the control that some of the stronger carriers have over their markets, the weaker carriers would in general gain, and the competitive balance of the industry would improve.

Our prior testimony focused on two policy objectives: first, easy access to airports, and second, reducing the marketing advantages of dominant carriers. As was mentioned earlier, the passenger facility charges legislation was an important step toward easing airport access. An additional step would be to encourage the use of preferential-use leases at airports. Revisions to the slot rule could ease access to the four slot-controlled airports and enhance the competitive status of carriers that have very limited access. Such revisions have been under consideration by DOT for some time. As with the slot rule, DOT has been considering revision of the CRS rules for more than a year. The competitive impact of frequent flyer plans and code-sharing are also practices that the committee may wish to consider in its deliberations.

Fourth, the urgent need of some carriers for additional capital has led to calls for legislation to allow foreign firms more opportunity to invest in U.S. carriers. Let me say a few words on that. The Secretary, as you know, relaxed rules governing foreign investment to allow unlimited access to debt capital from foreign sources and access to non-voting foreign equity capital up to 49 percent of an airline's total equity. The 25 percent limit on voting foreign equity, which is fixed by statute, remains in effect.

The unlimited access to foreign debt capital is subject to the condition that the loan not provide "special rights" to the debt holder that might imply control. In this regard, we are particularly concerned with what rights of recourse a foreign creditor has in the event of default. If I take out a car loan and I default on it, the bank can come and take it away and do what it wishes with it.

We think that increasing the access significantly beyond what the Secretary has already announced could effectively give control of U.S. carriers to foreign entries, and we would urge extreme caution in this area. It could amount in effect to giving foreign carriers de facto cabotage rights in the United States, that is, the right to provide airline service between points in the United States. It also, of course, raises some concerns about national defense and could complicate the Government's bargaining strategy in negotiating international route rights.

Many foreign carriers are government-owned and subsidized, and allowing such carriers to compete in the U.S. has some potential for distorting the competitive process. Overall, we think any action to allow foreign ownership of U.S. carriers or access by them to

U.S. domestic markets ought to be part of a reciprocal arrangement that allows U.S. carriers greater access to foreign markets.

Finally, there are more far-reaching policy options that have surfaced, such as placing a floor on airline fares or Federal financial assistance of some form for the industry, and these pose serious problems that would require extensive analysis before they could be considered for implementation. One suggestion was that airlines be allowed to retain revenues from the airline ticket tax. Now, this would be an indirect form of financial assistance for the industry. The airlines would increase their cash flow and reduce their need to borrow, but those savings will come at the expense of the Federal Government, which means we would have to borrow more.

As I mentioned, GAO has had some experience with previous bailouts and financial assistance programs, including those for Conrail, Lockheed, Chrysler and New York, and our experience with them has led us to issue a report in 1984 on the importance of, among other things, clearly defining the national interest in providing the assistance and protecting the Government's financial interests. Given the dramatic increase in Federal budget deficits since those other assistance programs were enacted, we think it's particularly important for any proposals along these lines to address those issues.

Finally, more fundamentally, we think other steps to enhance the competitiveness of the airline industry ought to be tried first. Placing a floor on airline fares, while it might have some surface appeal, would reverse the pro-competitive policy established by Congress in 1978, would be cumbersome to implement, and might well be ineffective in halting the slide in airline profits.

In conclusion, an industry with four or five carriers might, as some have suggested, be competitive if several carriers serve most routes. Action should therefore be taken now to ensure that the structural conditions exist for effective competition, and we think the failing financial health of several carriers makes such action even more urgent.

DOT has been considering new rule-makings on slots and CRSs for over a year, and even proposed rules still appear to be months away. Much more delay in these areas, Mr. Chairman, may result in these forms not having any potential to be effective. It may be too late. Opening the U.S. market to foreign competition and investment is something that we think deserves a great deal of consideration, and should not be done precipitately in our zeal to provide an infusion of capital into this industry. We suggest that there are different sides to this issue that deserve a full congressional airing.

Finally, even if all these pro-competitive policies are adopted, I must stress that they will be to no avail if the firms in this industry continue to burden themselves with the debt levels we're observing today.

We'll be glad to answer any questions.

Mr. OBERSTAR. Thank you very much, Mr. Mead. We really appreciate your thorough review of the many and complex problems that this industry faces but problems on which your judgment is so valuable because GAO and your team have been reviewing these matters over a period of many years—practically most of the past decade—so your insights I think are of great value, and your caution on many of these items are words that must be heeded.

I have a very great concern about a carrier like several of those who have gone down in the last few weeks into bankruptcy, either Chapter 11, Chapter 7 or some other form, that their assets—including as assets gates, slots, routes, authority to use those routes and slots given in many cases free of charge—developed by the carrier over time and under the buy/sell rule acquire market value. The whole purpose initially of providing routes and slots in the CAB days was to benefit the public, not necessarily to benefit a particular carrier, although that would result. The public interest was the guiding principle in making those judgments. Whether you agreed with them or not in the final decision, the Board ultimately made judgments that it thought were in the best public interest. The DOT does today in the same concept on international routes.

Now the company goes into bankruptcy. Its assets have to be liquidated. The public benefit is set aside now. The bankruptcy court looks only at the needs of the creditors and how can the assets of the bankrupt be disposed of to benefit the creditors and not the traveling public. What role can the Departments of Justice and Transportation play and what should they play in assuring that those assets are disposed of in a way that benefits competition to the maximum and that those assets go to the carrier or carriers which best would be able to make use of the assets to serve the public trust and to benefit competition?

Mr. **Mead**. The Department of Justice can interpose an objection under the anti-trust laws, and I think they should be scrutinizing all these proposed transactions, even ones not incident to bankruptcy. I think that's very important, and it's something that I believe, if it had been done more by the Department of Transportation, which had the authority in the mid-1980s on mergers and acquisitions, that part of the fix we're in now we would not be in.

Would anybody like to amplify on that?

Mr. **Wells**. Well, I would simply agree with that. I think the Transportation Department under Secretary Skinner has shown a much more pro-competitive approach, as evidenced in their efforts to allow Midway Airlines to establish a hub in Philadelphia to compete with USAir. Unfortunately, the weakness in the industry last year forced Midway to abandon that hub.

The Justice Department has certainly shown a similar strong concern with maintaining competition in the industry. We've been in touch with the staff at the Justice Department over the past year and have shared our data with them, data that we've collected on gate leasing at various airports around the country.

So I think there is a real concern at DOT and at the Justice Department with maintaining competition, and we think it's important that they continue to monitor the situation and to go to court, if necessary, to try to move those assets toward whichever carrier will provide the most competition at those hubs.

Mr. **Oberstar**. The problem with the role of the Justice Department is that it's a very appropriate but limited one. It's only to determine which of the proposals would violate anti-trust laws not which of the options would best serve competition.

Mr. **Mead**. That's so. That, I think, joins the issue, and I think the Atlanta situation is illustrative, because the facilities in Atlanta might well be worth much more to Delta Airlines than to any other carrier in the country, and the reason for that is obvious—Delta already has a big presence there, and this would simply reinforce it. So the question is: should the bankruptcy laws be implemented in such a way that the creditors' rights to maximize the return would have to give a bit when it's in the interest of an overarching Federal policy, like deregulation? If you lose Atlanta, there are a lot of counterproductive things that will occur to deregulation as a result of that decision.

So I think our tilt would be that the Justice Department and DOT, as well as perhaps the bankruptcy court, have to appreciate that underlying all this is a very strong Federal policy on competition, and sometimes creditors' rights might have to give way a bit.

Mr. **Oberstar**. The bids are not so widely disparate that the dollar amount is decisive in whether the creditors are going to receive the maximum amount on the carrier's obligation to them. It's a matter of a difference of degree. They'd be darn lucky to get anything, given what's happened, but the public interest has to be the overriding judgment on these rights, routes, gates, slots that were given out of the public trust to serve the public interest and ought now to return to that public interest.

Mr. **Mead**. It would certainly seem that way to us.

Mr. **Oberstar**. You know, as with National Park Service lands or U.S. Forest Service lands that are exchanged, for example, with a State to consolidate a national forest. Those lands are always given with a reverter clause that if the State puts that land to some use other than that for which it was originally intended, then it reverts back to the Federal Government. Those rights ought to be treated the same way.

Mr. **Mead**. There's a more fundamental underlying question here, that we've gotten ourselves in a situation where the airline somehow owns part of the airport for purposes of a proceeding in bankruptcy. It's not that way everywhere in Europe, as you know.

Mr. **Oberstar**. Well, I have a number of other questions to which I will return later. I want to give other members an opportunity to explore these questions with you, but first I do want to ask about the matter of competition on city pair markets. You've addressed the question of competition, whether the reduction in the number of carriers is going to leave a sufficient number to sustain competition with the reality of the hub and spoke system, which GAO has analyzed over time, and its impact on fares, driving fares up considerably in certain cases as compared to other markets. How do you make a determination on whether a reduction in the number of major carriers is going to reduce competition in individual city pairs, and how do you counter it?

Mr. Mulvey?

Mr. **Mulvey**. It's conceivable, of course, that every time an airline goes out of business another airline will jump in and fill in for it, but we think it's unlikely that that's going to be the case in all circumstances. As you get fewer and fewer competitors, you are going to have more and more markets that become served by only one or two airlines. As our testimony states, about 45 percent of all the markets right now only have one or two competitors.

It is true that since deregulation and with the creation of the hub and spoke system that more cities have more carriers than before deregulation, but as carriers continue to go out of business, we're going to find more and more with fewer and fewer competitors.

Mr. MEAD. I'm not sure we answered—you wanted to know how one ensures that the city pairs will be——

Mr. OBERSTAR. We have this shrinkage in the number of carriers down to—it was interesting yesterday sitting up on this side of the podium to see the faces in the audience as the Secretary or someone said, "Well, three carriers," and all these folks were jumping around in the audience, "Does that mean me? I'm out?"

Mr. MULVEY. If there were three or four——

Mr. OBERSTAR. I don't want to get in the numbers game of how many are going to be left, but if there is some lesser number in a year or two, maybe sooner, how do you assure that you're going to have competition?

Mr. MULVEY. I don't think you can assure that there's going to be competition unless you required every carrier to serve every market, and I don't think that's going to happen. I think it's reasonable to assume that as you have fewer and fewer carriers, the carriers will begin finding those areas of the country or the world that they want to specialize in, and you're going to wind up with more and more oligopolistic and monopolistic markets.

Mr. OBERSTAR. They'll tend to serve the markets where they can generate the greatest profit.

Mr. MULVEY. Right.

Mr. OBERSTAR. And not to serve those that don't bring as great a return.

Mr. MULVEY. Yes.

Mr. OBERSTAR. And that also may have the effect of reducing the number of sub-major carriers also that would serve those markets, since there wouldn't be much incentive for them to do so.

Mr. MEAD. I think if you get down to two or three carriers, Mr. Chairman, you're going to be perilously close to a situation where talking about competition in a deregulated market is almost a pie-in-the-sky situation, unless we take some action now, some very pro-competitive action now, and we think that has some promise and could effectively assure competition, even if you have five carriers. I wouldn't want to reduce that number to two or three.

Mr. OBERSTAR. Well, you have outlined marketing practices, slots, airport access, and a number of other items—the foreign investment question—to which we can return later. My time has very obviously expired, and the Chair recognizes Mr. Clinger.

Mr. CLINGER. Thank you very much, Mr. Chairman.

Mr. Mead and your colleagues, we thank you as always for a very thought-provoking, very thorough and very excellent testimony.

One of the suggestions that has been made about the demise of Eastern Airlines was that over the last few months of the airline's life their pricing practices—low prices to try and keep afloat and try to keep flying—had the effect on the healthier airlines of weakening them. Is that something we should be concerned about? In other words, is there an advantage to propping up weaker airlines if in fact it may result in bringing down the whole industry? Are we going to be weakening the healthy ones by trying to keep the less healthy ones alive?

Mr. **Mead**. I think one of the underpinnings of deregulation is that you're duty-bound to let competition be the primary regulator of fares. Now, when we start talking about subsidies and special techniques for buttressing the weaker carriers, I think you're crossing the line where it's counterproductive to the principles of deregulation. On the other hand, a fly in the ointment in this industry is that the government has, through sins of omission and in some cases sins of commission, adopted policies that themselves are not compatible with a deregulated environment, and we think those need to be changed.

For example, if it's government policy to allow an airline to buy up an airport for 30 or 40 years, it's difficult to see how you can have competition flourishing in a situation such as that. Slots are another issue. In Chicago, American and United have a substantial share, a very valuable portfolio of slots, and people can't compete freely in that market because of the way the current slot rules are set up. CRSs—it's an odd situation indeed when if you want to fly on one airline you have to pay another airline a fee that's more than the cost of the basic booking service. It seems somewhat anomalous to us.

Mr. **Clinger**. Of course, in the Eastern situation it really wasn't so much anything that was done here as much as it was by the bankruptcy court, which is really the entity that kept them afloat as long as they were. I suspect that in a similar circumstance, which we may see, there's going to be an awful lot of pressure on the bankruptcy court not to allow the thing to drag out to the point where the assets become basically worthless to the creditors. So I would suspect that if there are future liquidations, they're going to occur more rapidly rather than be dragged out. It will be a faster process.

You have indicated that there will be a major need for new capital, new investment to address some of the items that have either been enacted by Congress in legislation last year or else are safety considerations, noise considerations, aging aircraft, which are going to require a substantial investment; yet we did hear yesterday from Secretary Skinner that as a result of his survey of all the CEOs of every airline and of economic analysts in the business that the capital that would be needed for addressing those items as well as others is just simply not available in this country.

Given that fact, shouldn't we be considering the possibility of allowing foreign investment if we're really talking about the very real needs for investment that you have outlined?

Mr. **Mead**. Yes. For the policies that the Secretary recently announced, the questions we raised had to do with the unlimited debt provisions. In other words, under the new policy, a foreign creditor can acquire an unlimited amount of debt in a U.S. airline, and we're concerned about what that may mean if there's a default—which, after all, for the more fledgling airlines in this country, with 96 percent of their capitalization ratio already debt, is a likelihood. It's possible that they would default. What happens to the capital if they default? Can the foreign creditor come in and just take the planes?

So for what the Secretary has announced so far, I think it's reasonable, but I don't think it's a panacea, Mr. Clinger.

Mr. **Clinger.** I think there's no question that in the present climate it would look like a pretty shaky investment. I think that given the short term problems you've identified that it would not be one that people will be avidly seeking. On the other hand, I think there is a recognition that once we get through the terrorism threats and the price threats and the price problems and some of those things that it may well be a worthwhile investment to consider.

The bill that I've introduced really looks to increasing the equity provisions of voting stock, not debt, because we recognize that that could be a severe impediment to doing this. But it also contains a provision saying that no investment could be considered unless it was with an individual from a country that had a pro-competitive agreement with the United States and that had total reciprocity in terms of percentage of investment and a number of other considerations relating to national security.

All I'm suggesting is that I don't think that we can just sort of say we're not going to consider that, that there may be a need in order to keep a healthy industry here to allow that kind of investment. I guess my time has expired.

Mr. **Oberstar.** The gentleman will have further opportunities.

The gentleman from Texas, Mr. Laughlin?

Mr. **Laughlin.** Thank you, Mr. Chairman.

Mr. Mead, thank you very much for your very thoughtful and thorough testimony. I certainly share many of the thoughts you conveyed. One disturbing thing I heard this morning from Congressman Dorgan is that he doesn't think leveraged buyouts are behind us. I share your concern that firms that continue to be burdened with debt don't have a good future, and it seems like in this committee all we talk about is debts of the airlines.

I think back to last year when, before this committee, a couple of gentlemen from a Wall Street firm were here touting leveraged buyouts as being the things that we need, and as they testified I got greatly concerned, because they didn't say anything about the public needs and public transportation. They were talking about profits. There's nothing wrong with that, but they were talking also about reducing air service to cities the size of Memphis, Tennessee, which is substantially larger than the largest city in the district I represent.

So I'm concerned about all this debt business we continue to hear, and I just wonder what are your thoughts as to whether leveraged buyouts are dead, or are they coming back to haunt us some more in the future?

Mr. **Mead.** Well, one reason people are—when they use the term "infusion of capital urgently needed," that's not synonymous with, but it can be the functional equivalent of, a leveraged buyout. For example, one reason you're hearing a lot of talk about foreign investment is because foreign investment can come over here in the form of extraordinary debt. So I don't think it's behind us. I think the Congressman is correct, though I hope that this industry will reconsider the attractiveness of having high debt levels after the experience of the last four months, where we've seen one carrier after another enter bankruptcy.

Would anyone else like to add to that?

Mr. **Wells**. I'd just like to make one point about high debt levels. I think we certainly share your concern with leveraged buyouts where the high debt is taken on primarily with the motivation of front-loading profits, where the party that's buying out is simply assuming that the profits of this carrier will extend indefinitely into the future, and the LBO allows you to capitalize those profits up front.

There are other reasons, of course, for taking on high levels of debt, and I think in some cases carriers have felt that they needed to expand substantially in order to acquire a large enough scale that they could compete effectively in the airline market. America West, for example, has a fairly high debt level, which was taken on, I think, primarily to finance expansion so that they could achieve sufficient scale that they could compete effectively.

So I think I would be somewhat leery of imposing overly stringent restrictions on the level of debt that a carrier could take on, because those kind of restrictions could prevent a carrier from competing effectively. It's an issue that needs to be given a lot of careful thought, I think.

Mr. **Laughlin**. In another area, Mr. Mead, you testified about deferring the ticket tax to the airlines. How do you justify that to the public, who is paying this tax with the expectation that it will be used by the Government to improve air safety at the airports and airways? Isn't that really a subterfuge to do that?

Mr. **Mead**. Yes. I pointed that out in the testimony not as a GAO suggestion but to comment on it, because it's one of the range of items that has been suggested. I think it would be very difficult to reconcile that, and also the use of the ticket tax with deregulation. In any event, it's not entirely clear that the infusion of revenues from the ticket tax to these airlines would necessarily result in your achieving the objective you intend; it might result in lower ticket prices, which is not the goal here.

If you follow what I'm saying, the airlines would all presumably equally get whatever ticket taxes they collect, keep them for two or three months or some period of time, but they would consider that as revenue in their pricing scheme.

Mr. **Laughlin**. Wouldn't that just continue to make the strong stronger and the weak weaker? Because you couldn't say that to a Delta or to an American, who you've pointed out are financially stronger today, and wouldn't that benefit them a great deal more than it would benefit a Pan Am or a Continental, who you have pointed out as being in a so much weaker financial position?

Mr. **Mead**. Yes, and I think it runs counter to the principle of letting competition be the primary regulator of fares and letting the stronger survive and the weaker go their way.

Mr. **Laughlin**. If you were going to help the weaker, you would probably have to allow the weaker airlines to keep the tax to help their cash flow and not permit the stronger to keep their tax revenues, wouldn't you?

Mr. Mead. Yes, and it gets rather entangled when one takes that approach. Frankly, your best bet from a policy point of view are pro-competitive policies that promote an even playing field. And even those will not be a panacea for some of the carriers that are around the block. I'm not sure what, if anything, can be done to keep them going that's within the realm of reason.

Mr. Laughlin. Well, I certainly appreciate your views and your testimony today. Thank you very much.

Mr. Mead. Thank you, sir.

Mr. Oberstar. Thank you.

Ms. Molinari?

Ms. Molinari. Thank you, Mr. Chairman. Just a brief question.

Mr. Mulvey, I know you said it's in your testimony, but I haven't had a chance to go through it, and I'm sorry I was late. Did you not give the figure that 45 percent of the routes are serviced by one or two carriers only?

Mr. Mulvey. Yes, passengers.

Ms. Molinari. Taking all I've heard since I've come in here, you are saying that if Government came in and regulated only to the extent of making sure that there was not a geographic monopoly on certain slots and gates that there would be additional competition from other interested carriers to expand that field. Is that your position?

Mr. Mulvey. I'm not sure I understand your question.

Ms. Molinari. You've given me the statistic which I found rather startling, although not surprising, being a traveler out of Newark Airport, where Continental is the only one who can service this route at a tripling of the rate since deregulation has occurred—so much for the competitive spirit and affordable airlines—but it startled me to hear that only 45 percent of the routes are only serviced by one or two, and I'm wondering what we do to increase that, and just going through what you've said I thought that perhaps you suggested that one of the reasons why that occurred, such a limited amount of carriers servicing a particular area, is because of the lack of openness in the field with regard to access to slots and gates.

Mr. Mulvey. Right. That's a large part of it. Access to slots and gates, and the existence of marketing practices, that there are barriers to competitive entry at many airports and on many routes. An airline looks at the potential in a market and finds that it's too costly to try and compete. If we were to adopt more pro-competitive policies that would open up any of these markets and eliminate or reduce some of these entry barriers, then you might have a greater number of passengers flying on routes with more competitors. By the way, it's 45 percent of all the passengers flying on routes served by one or two.

Ms. Molinari. Okay, thank you. I appreciate that.

Mr. Oberstar. Mr. Duncan?

Mr. Laughlin. Could I ask one question on the very point that Ms. Molinari asked?

Would the gentleman yield?

Mr. Oberstar. If the gentleman will withhold, I'll recognize at this point the gentleman from Texas.

Mr. LAUGHLIN. I was just as shocked about this 45 percent figure as Ms. Molinari is, and I wonder is that non-stop consideration or is that two- or three-stop? To follow that, from Houston I can fly to Washington, DC, on Continental only, but if I were to get on Delta, I could fly to Atlanta, Nashville or Dallas-Ft. Worth, and I'd say then you've got two airlines; then I can go to another one, and I think I can fly to Charlotte and switch planes, and I can get on U.S. Air and fly to Pittsburgh, I believe it is. Are you counting all these other options of flying out of the way to get to Washington, DC, as competition? Because Continental is the only one that flies non-stop.

Mr. MULVEY. That includes both non-stop and connecting service.

Mr. LAUGHLIN. Well, then I'm still startled. Thank you very much.

Mr. OBERSTAR. Mr. Duncan?

Mr. DUNCAN. Thank you, Mr. Chairman.

I had to be at another committee meeting. I'm sorry I just now got here, so some of this may have been covered. Yesterday in these hearings we heard testimony that the primary barrier to ease of entry into the industry is the capital problem. If that's true and in light of that, is there anything realistic that we can do to help ease entry into this industry?

Mr. MEAD. There are a range of actions that I would characterize as pro-competitive that can be taken, that had better be taken, because if they are not, I'm not too optimistic about the future of deregulation. They fall into the areas of the computer reservation services, the leasing practices at airports, the taking hold of the passenger facility charge, dealing with frequent flyer programs and code-sharing——

Mr. DUNCAN. Let me go back to one thing you just mentioned. The computer reservation service was mentioned several times yesterday. Now, what do you think we should do about that? Are you saying we should come in and eliminate that or do away with it, and is that feasible, possible?

Mr. MEAD. You have several options with CRS.

Jack?

Mr. WELLS. Well, first of all, I would emphasize that the computer reservation system is an essential part of the marketing network of almost all airlines today, so that we would certainly not suggest doing away with computerized reservation systems. In our testimony two years ago, what we focused on was the large dollar volume of transfers that took place from one airline to another as a result of these CRSs. The airline that owns the CRS charges a booking fee to the other airlines that book their flights using that CRS, and the booking fees that are charged are well in excess of the cost of providing the booking and in some cases are double the cost of providing the booking.

So we calculated that even after you take into account the cost of providing the booking at a reasonable profit, the major airlines that own CRSs—United and American—receive over $300 million a year each in transfers from the other airlines in profits in excess of a normal profit rate in providing these bookings. So one option would be to require a reduction in the booking fees so that the airlines that did not own CRSs would not have to pay these excess fees to the airlines that do own CRSs.

Another option would be to—some of the airlines own CRSs, but their CRSs have very small shares of the CRS market, and it's difficult for them to expand their share of the CRS market because there are very restrictive contract provisions between the CRS owners and the travel agents who use them—long term contracts, minimum use clauses that prevent a travel agent from using more than one CRS at the same time—and that means that it's very difficult for the minor CRS owners to eat into the market share of American and United. So reforming some of those contract provisions would be another option.

Mr. DUNCAN. Mr. Mead, you say in your testimony "Competition can be harmed if additional carriers cease operations." I see that, and possibly you've covered this through your testimony or other questions, but if you had to predict the future, let's say five years or 10 years down the road, how many airlines do you see in existence? Do you think like some people that we're soon, in five or 10 years, going to see just two or three major airlines? What is your prediction in that regard?

Mr. MEAD. Well, I understand that Secretary Skinner yesterday used a range of—what was it? Three to seven is what the papers were saying. I'm not in the business of being a forecaster; otherwise, I would be very wealthy, and I'm not, but I think you're going to lose a few that you have now. I don't think five or six is outside the range of what could happen, but I think there's a silver lining to this. I believe that the Government can undertake some firm pro-competitive action and still have a reasonably flourishing competitive environment. But if those actions aren't taken, there is real cause for alarm here.

Mr. DUNCAN. If it was totally and completely up to you, which we all know it's not, but if it was, what is the one thing that you think would be the best thing and the most major thing and the most effective thing that we could do to help increase competition or to ease entry into this industry of new airlines?

Mr. MEAD. I believe the United States years ago made a very fundamental mistake that's not easily compatible with competition, and that is the relationships between airlines and the airports. I would change that if I were the czar. I'm not and it may be too far along to do anything about it, but it seems to me that the airports became very reliant on the airlines to finance them, and over the years strong relationships built up that make it difficult for other carriers to get in. Slots are another area, and CRSs is another. I think some of the movement on the foreign front is healthy, but slots, CRSs, and the relationships between the airports and the airlines would be strong targets of opportunity, from my point of view.

Mr. DUNCAN. Am I understanding you correctly? Is what you're saying really that what we need to do if we want to save some of the existing airlines or get other airlines into it is to move more in the direction of a free enterprise system or a free market system for the airlines?

Mr. MEAD. Yes. I might add that a strong counter-balance here is that an airline like American has made an enormous investment in its CRSs, and yes, they've made lots of profit off of that, too, but it was through the ingenuity of some of these carriers that are now the owners of the dominant CRSs. They made big investments.

Mr. Oberstar a few minutes ago talked about slots and aren't they really public property, and it's odd, isn't it, that some of the most valuable assets of these airlines are pieces of public property that they sell among themselves?

Mr. DUNCAN. All right. Thank you very much.

Mr. OBERSTAR. The gentleman will have the opportunity to resume in a few minutes.

I want to pursue a few areas of particular inquiry. First of all, on the matter of foreign investment, the question needs to be asked and I think—or at least I hope — more thoughtfully answered than it was yesterday, because yesterday it was just sort of asked but taken for granted that investment capital is not available in the United States for the airlines because they're such poor investment risks, not high enough return on investment. There was no showing, no specific evidences of attempts made and failed to attract domestic investment dollars and for what purposes.

Each carrier may have a different investment requirement. Those that are in severe financial distress have a cash flow problem. Others that are on the rise—that is, a new carrier like, let's say, America West, relatively new and trying to develop markets, or one of the other carriers who testified, Alaska, that was bidding on some international routes and denied—they had a need for investment capital. Another option would buy new equipment.

It strikes me that each of those needs, different as they are, can find a responsive market in the United States where there is money available and willing to be patient to allow that investment to grow. Then there are other kinds of investments, like SAS interest in Continental for, I suspect, purposes other than seeing their 18 or 19 percent dollar investment in that carrier grow because it's such a great rate of return.

My question is two-fold. If investment capital is not available generally in the U.S. for the airlines because they're such a poor risk, one, why are foreign investors smarter than the U.S., or two, why are they dumber than our investors in the U.S.? Or three, more likely, what are they really after?

Mr. MEAD. Well, I think the first proposition, that the investment dollars are not available in this country, is probably incorrect. But the point here is why would a foreign investor be interested in some of these airlines whereas a domestic investor might not be? The answer lies more in what the purpose of the investment is. I think it's useful, Mr. Chairman, to look at who the identity of some of the investors might be. I don't think it's a shortage of money in the United States so much as it is the motivation here, and that's one of the areas that concerns us.

For example, if someone were to offer you an investment where you could buy into an airline that had a 96 percent debt-to-capitalization ratio already, you might not see that as an average investor as something that's likely to return a large yield. But it's conceivable that some foreign investors would look at that and say, "Well, if I could get some form of control, either through a back door on a loan, a secured interest type loan, or a direct equity interest, then in effect wouldn't I own the airline?" And even though that airline may have a U.S. flag on it, the backing of the foreign interest could make it the functional equivalent of a foreign airline that could provide domestic service.

Mr. **Oberstar**. That's exactly what concerns me, that the interest of the foreign investor is not the stated purpose—just to be a friendly guy, to give you a little money, you struggling U.S. carrier, and help you along and meet your debts; we'll be patient, and we'll wait until you can pay us back. They're looking for a measure of control. These are no fools, these foreign air carriers. They're very shrewd, they're backed up by their governments, owned by their governments, controlled by their governments, subsidized by their governments. They're no fools. They understand this is the world's largest open free market, and the best way to get in there without having to negotiate a bilateral is to buy a piece of the action.

Mr. **Mead**. That's right. I know you were in Brussels last year, and you spoke to Mr. Sorenson, and we followed you by a couple of months, and one concern we have here, Mr. Chairman, is that while EC-92 may not occur on a date certain and it may be a somewhat iterative process, we in the United States certainly want to have something left for that negotiating process.

Mr. **Oberstar**. And they will certainly have a great interest in developing through an investment in the U.S. carrier the network of that carrier that can best serve the international routes, which are the high profitability sector, and have very little interest in developing service to the communities of the nature that Mr. Dorgan testified to earlier today or that most of us on this committee represent—small, non-hub communities served by our regional or commuter carriers or air taxi service or, as I suggested earlier, by the stork. [Laughter.]

Mr. **Wells**. If I could add to that, Mr. Chairman, there has been a lot of discussion since the Secretary's change in policy about what level of either equity investment or debt investment would be sufficient to acquire control of a U.S. airline, and I think it's probably——

Mr. **Oberstar**. Yes, I raised that question yesterday. Can you address that? Can you differentiate or distinguish between debt and equity investments?

Mr. **Wells**. The point I was about to make is I think it's probably an illusion to believe that there is any particular percentage level that can be used as a bright line distinction that allows a foreign interest to acquire control. I think it's probably more appropriate to speak in terms of influence rather than control, that as your level of investment in a U.S. carrier increases your level of influence on that carrier's decision-making increases.

It's possible to have some influence even without any investment. For example, the code-sharing arrangement between United and British Airways gives British Airways some influence over United's decision-making, even though they have no investment whatever, and the fact that U.S. and foreign carriers like Swissair and Delta have entered into cross-ownership agreements is designed to supplement and reinforce the cooperative marketing agreements that they already have so as to increase that amount of influence.

I think the amount of influence is also dependent not just on the percentage of ownership by the foreign carrier and the U.S. carrier but in the nature of the U.S. ownership. If you look at the relationship between SAS and Continental, the influence that SAS exerts over Continental certainly increased dramatically when Frank Lorenzo gave up his ownership stake and his executive control over Continental, because if you don't have a strong U.S. executive that is running the U.S. flag airline, then the foreign airline can exert a greater degree of influence at any given percentage level of equity participation.

Mr. OBERSTAR. You underscored the concern. So the holy grail of foreign investment as a solution to the industry's problems is as non-existent as that mythical item.

All right. Let's move to marketing practices on CRS. Your testimony suggests that the Department is not likely in the near future to issue a rulemaking on CRS, and you revisit some of the items that we've discussed in the past: Booking fees, eliminate them; have a common CRS system; minimum use fees, eliminate those; eliminate the minimum five-year terms of travel agents. I have introduced legislation—I don't know if you've had an opportunity to review it—to deal with the CRS. This legislation incorporates some of those concepts. Perhaps you could discuss further what legislative action could be taken right now that would be the most beneficial.

Mr. MEAD. When you enacted the passenger facility charge legislation, you included a provision that facilities financed with PFC money not be exclusive use leases, and I think that was in recognition of this general problem. I think you probably could go a bit further. It's a hard bullet to bite, but some hard medicine may be in order here. How long do we want to allow the practice of exclusive-use leasing to go on in this country?

Slots—I understand the Secretary is going to be coming out with a rule, and maybe legislation will not be necessary, though I know this has been a constant source of frustration to the Congress, the delays associated with the revisions to the slot rule.

Frequent flyer programs—they may be very popular, but they're not particularly favorable to competition, and the reason why is if you take a market that's already concentrated with a dominant carrier, people become vested in a particular frequent flyer program and will tend to fly that carrier. If you have another airline that's interested in entering that market, they have a long row to hoe, particularly when you add up all the other barriers to entry. So frequent flyer programs is another one.

Code-sharing—a lot of debate on that, but the code-sharing arrangement is one where separate corporate entities steer traffic to each other formally through the CRS system.

A lot of these areas, Mr. Chairman, of course, don't lend themselves to just one answer; otherwise, we'd already have given it. They are very contentious matters, and if they weren't, they perhaps would already be law. But those are some of the areas.

Mr. OBERSTAR. On the slot issue, which our legislation directed the Secretary to study and to make recommendations, I must say I was more than a little disturbed at his passing comment yesterday that the slot control at National leaves a great deal of unused capacity at that airport. I was not aware that there is a great deal of unused capacity. Maybe at times of the day when carriers are not interested in flying and are not willing to use those slots, but at the preferred time when carriers want to bring passengers to National, there certainly is no excess capacity. Secondly, that statement ignores the impact of increased flights in and out of National on the surrounding communities who are already vehemently opposed to the current level of travel.

Have you given this matter of the four slot-controlled airports some thought, if not from the noise impact standpoint, then from the competitive impact? How do you increase competition at those airports if airlines can't get in because there is some ceiling on the number of flights in and out? One of the carriers yesterday said, "You can't call yourself a major carrier if you can't get into the Nation's major cities—Chicago, New York, and Washington, DC—and we can't get in there." Well, they can't get in at least because they didn't have deep enough pockets in the past when slots were available for purchase I really consider the sale of slots to be a reprehensible policy done long before I was in a position to do anything about it, but at any rate, slots are not available at a price they can afford. That's why I raised the question about the bankruptcy proceeding as to how the Government can best serve the overall interest of competition and the public interest in access to those airports.

Mr. **Mead**. Yes, we have given that some thought.

Frank?

Mr. **Mulvey**. We have looked at the slot question now several times in the last few years. We feel that it was a mistake to give these slots to the airlines and make them airline assets. In fact, theoretically, they are not the airlines' assets; they still belong to the Federal Government. But the airlines are allowed to treat them as assets and to buy and sell them. We have looked at the possibility of a lottery whereby at least some portion of the slots are made available. That has been tried in the past.

The slots in many ways should really be considered the airport's asset. The airport operators have an interest in making sure that many airlines compete and that the people living in that city get an opportunity to fly amongst different carriers. As it is right now, the ownership of the shots has been grandfathered, and the airlines have an asset which they were granted by the Government.

Mr. **Oberstar**. Yes, Mr. Cherlow?

Mr. **Cherlow**. I'd like two points to add to what Mr. Mead and Mr. Mulvey have said. One, we've been doing some analysis related to factors that influence airline fares, and as was reported in the testimony, slots are definitely one factor where the evidence suggests that the possession of slots gives airlines a certain ability to charge higher fares because other airlines are not able to compete without access to the slots.

Mr. **Oberstar**. Yes, I think that was a very revealing element in the testimony this morning. Please proceed.

Mr. **Cherlow**. The second part, Mr. Chairman, relates to something Mr. Mead said earlier about airline relationships with airports in general and this whole question about capacity. What we've seen certainly since airline deregulation has been a large increase in the number of flights and number of travelers using air service without a concomitant increase in airport capacity, and slots are a manifestation of that—that we have these limits, and to the extent that public policy can be directed at these relationships between airlines and airports and in general at the capacity issue, I think that this is one way that we can help preserve a competitive airline industry.

Mr. **Mead**. I think one option on the slots is you could reaffirm what's already in the regulations, that these slots are really the property of the Federal Government subject to withdrawal at any time. That's already established. We just don't put substance behind what the literal rules say. Withdraw some of those slots and put them out to the free market as part of a lottery; you need not pull them all out, because that could be very disruptive to some of the investments that United and American have made, for example, at Chicago O'Hare we also could ban the practice of selling them back and forth. At least make it clear that if you're not going to use this slot, it's not yours to sell to somebody else; it's the Federal Government's property, it reverts to the Federal Government when it's not used. And also the time line under which the slot would be let would be more limited in duration than it is now. Now in effect, it's in perpetuity.

Mr. **Oberstar**. Well, there is a 65 percent use threshold now. Is that too high?

Mr. **Wells**. No, I don't think it's too high. If anything, it's too low.

Mr. **Oberstar**. Too low?

Mr. **Wells**. Yes. I think one concern that we have is that the limited number of slots that we have now are not being fully used. I think the 65 percent "use or lose" threshold is probably too low. We also found some evidence in our analysis of the slot market that you had some slots that were intended to be used by jet carriers that were being used by commuter carriers instead, and, of course, commuter carriers fly smaller airplanes, so you have fewer people able to benefit from that slot if you have a commuter carrier using the slot rather than a jet carrier. And of course, the commuter carriers have their own set-aside of slots available to them.

Last year when we testified on barriers to competition in the industry, we suggested a system of leasing slots so that, for example, slots could be leased for three-year periods on staggered leases so that there would always, every six months, be some slots whose leases would be expiring, so a carrier that wanted to enter a slot-controlled market would find some leases expiring and could bid on those leases that were coming up for renewal and would have an opportunity to enter the market at that time.

Mr. **Oberstar**. Thank you. I won't pursue this further. You've given some avenues of thought, and I think I would like to have additional discussions with GAO about the slot issue and develop some approaches.

Mr. Hammerschmidt?

Mr. **Hammerschmidt**. Thank you, Mr. Chairman.

I just want to comment that when Ken Mead comes to this committee with his team we learn a lot. They're good witnesses, and we appreciate it.

With all the concentration of the air industry, what's the minimum number of major carriers you'd need to have a viable transportation system? Have you already been asked that?

Mr. **Mead**. Yes, and we ducked it.

[Laughter.]

Mr. **Hammerschmidt**. I'll look at the record, then.

Mr. **Oberstar**. He did a very good dance around that issue, I would say to the gentleman.

Mr. **Mead**. Maybe saying "ducked" is being a little hard on ourselves. I think the Secretary yesterday told you that his estimate was that we can range somewhere between three and seven, and I would not want to be in your shoes or the Administration's shoes if you only have two or three carriers and try to pursue a competitive environment. That would require an extraordinary amount of oversight to keep it competitive. I don't think it's outside the range of probability that we will end up with five or six in the fairly near term, in the next two or three years.

Mr. **Hammerschmidt**. If you boil it down to that and carriers decide to take the lucrative markets and leave a lot of unserved people out there in other markets, do you think cabotage would be an answer to filling the void?

Mr. **Mead**. Pardon me. Would that be the answer to what?

Mr. **Hammerschmidt**. The answer to filling the void competitively?

Mr. **Mead**. No, I think that cabotage as an answer to our competitive problems is a good ways off. I think you do need to be careful, though, at this time when we're discussing the need for infusions of capital—and for some reason foreign investors are going to be more attracted to our industry than U.S. citizens are—that you don't end up with a situation where you have functional ownership of U.S. airlines by foreign interests and grant cabotage through the back door. You might have the U.S. flag on the tail of the plane but not necessarily a U.S. interest in control. We think that the foreign issue probably ought to be handled more in the context of reciprocal negotiating arrangements.

Mr. **Hammerschmidt**. Thank you.

Thank you, Mr. Chairman.

Mr. **Oberstar**. Ms. Horn?

Ms. **Horn**. I have no questions, Mr. Chairman.

Mr. **Oberstar**. Mr. Geren?

Mr. **Geren**. I apologize for missing the first part of this. I was in another committee meeting, and I hope I'm not covering something you already discussed at length, but I'd just like to ask the question if you think that the PFCs of last year are going to in any way alleviate some of the problems that you've discussed—the access to airports and the ability of new entries into the market?

Mr. **Mead**. Yes, I do. That was a very important, if not courageous, step for the Congress to take, but you can go further. I think the committee needs to promote more the preferential use leases. You have done so to a certain extent by requiring that PFC monies not be used for facilities leased on an exclusive-use basis, but it's going to take a long time for that to take hold. The subcommittee could legislatively promote the greater use of preferential-use leasing at airports throughout this country in the best interest of the deregulation policy and interstate commerce.

Mr. **Geren**. All right. Thank you.

Thank you, Mr. Chairman. I have no other questions.

Mr. **Wells**. I would just add to that that while we supported the PFC legislation, the PFC legislation will have a long term impact. It will have an impact only as those revenues accumulate and as they are used to build additional capacity, and it will take several years for that to happen, and what we would urge is some action to try to allow more competitive access to the facilities that are already available at the Nation's airports.

Mr. **Oberstar**. Mr. Hammerschmidt?

Mr. **Hammerschmidt**. Mr. Chairman, on the PFC issue, have you been into the fact the way they're writing the rule contrary to what we had directed in the committee report? Have you addressed that issue?

Mr. **Oberstar**. No, we did not pursue that matter yesterday with the Secretary. I had intended to take that up sort of at the end of the presentation, but we had had him there for four hours already.

Mr. **Hammerschmidt**. Well, you may not want to get into that with this group of witnesses at this time.

Mr. **Oberstar**. There are a number of concerns, and we will revisit that subject.

Mr. Mineta?

Mr. **Mineta**. Thank you very much, Mr. Chairman.

Mr. Mead and team, as Mr. Hammerschmidt has indicated, we always appreciate the fine work that you, Mr. Mead, and others within your division do.

I'd like to ask about this issue that you point out on page 12 about releasing petroleum from the strategic petroleum reserve. How do we if we are to do that? And now that I chair Surface Transportation Subcommittee, I've got 47,000 trucking companies out there who are in desperate straits. How does the American railroad system? How do these people belly up to the board and say, "Hey, hold it. What about me?"

See, I'm not sure that the strategic petroleum reserve ought to be used for price increases. I think it ought to be used when the supply gets cut off. Then we're really in deep mud, and we ought to have something to help us out. That's to me what the strategic petroleum reserve is for.

This is a short term answer to a problem that is really of a long term foundation in terms of where are we as a country going to go in the future, and so I would hope that this would not be something that gets really offered up as a solution. Maybe as a thinking piece, but I hope we don't frankly—even though you have raised this as an issue here, I frankly hope that we don't adopt this as a public policy approach.

Mr. **Mead**. We would share your view on that. It's in the statement simply because we know there are a range of options that have surfaced, and we wanted to treat each one. Really for two reasons, I think, your point is well taken. One is that it's not at all clear that the price of oil is going to be particularly problematic in the months ahead. It's dropped from $1.11 per gallon to 71 cents, and before the Persian Gulf crisis it was 56 or 58 cents.

Secondly, in addition to the interest you point out, I have a grandmother, and she probably would like to have assistance, too, and I don't know how you explain to the elderly population or to other people in need why they can't get special assistance from the Government and why the airlines can. Your point is well taken.

Mr. **Mineta**. I think the investigation, frankly, I'd like to see is this: As of August 2, in terms of pricing of petroleum products, did the oil companies raise prices on gasoline "X" amount but raise jet fuel by a very large amount, thinking "Well, we'll raise the price and stick the airlines for that increased price. We won't enrage the public. We'll increase it but only this much," but really put an unfair portion of that burden on the airline industry and pass it through, so to speak, in that kind of a mechanism?

As I say, I know very little about the oil pricing mechanism, but I just get the feeling sometimes frankly that there was a disproportionate increase and that the airline industry had to eat it, and when you think about, what is it, a one penny increase for American or United is a $28 million increase in their operating expense and knowing how much it's gone up, this is a big blow to the total industry. So I'd rather, you know, go after them, frankly, to see whether or not there's been some unfair pricing mechanism.

Let me ask—you also indicate that you would consider allowing the airlines to retain revenues from the airline ticket tax. Frankly, I think this really, again—being a user fee, I feel very strongly about maintaining the trust in the trust fund and the user tax system, and I think this really breaks it. I would rather—because I thought about in 1982, I guess, when we did away with the investment tax credit. I think the investment tax credit really was the thing that stopped the airlines from making any further investment orders, et cetera, and consequently we've ended up with aging fleet, and we've ended up with airplanes that consume more fuel and that are more inefficient than newer aircraft that we should have gotten had we kept investment tax credit in place.

There were abuses in the investment tax credit system, but it seems to me in the long run we would have been better off keeping that in place but not doing what you're suggesting here, and that is letting them keep the revenues of the airline ticket tax, because again, I think that just breaks the historical relationship between the user fee, trust fund, capital improvements, et cetera, and I would rather retain that and try to do something on investment tax credits or other things on that tax policy side. Or maybe loan guarantees or some other area of public policy than to go down this route of letting them retain—and again, the objective is the same in both instances, what you're trying to do and what I'm suggesting, but the question is how do we get there, and I think we're just breaking the whole idea of the trust fund if we allow the airlines to keep the ticket tax.

Mr. **Mead**. Well, the fact is that we totally agree with you, that this item is in the testimony not as a GAO suggestion but as a suggestion made by others that we are reviewing and the text under it should make clear that we're not supportive of that, either. It is an issue that has surfaced, and what we're trying to do here is lay out what the essence of the proposal is and also to point out that we think such an approach would be quite inconsistent with the purposes of the Airline Deregulation Act.

There are several other such suggestions that we review in here. For example, we point out the example of bailouts such as Conrail, Lockheed, Chrysler and New York City not because we think that that's a good idea, but simply because it's a fact of life that this is one of the options that some people are considering, and in the public policy forum we wanted to address both the pros and cons of it.

Mr. MINETA. I apologize for not having been here when you testified. Could you summarize for me very quickly then the portion having to do with foreign investments in U.S. airlines? Are you against it, for it, modifications?

Mr. MEAD. Insofar as what the Secretary has already announced, we don't find that particularly problematic. We do have some reservations, though, about what rights of recourse the unlimited access to foreign debt provision might imply. The Department has not been particularly clear on that, and we see some possibly dangerous ramifications of it. That's for what he has already announced.

Beyond that, we think further liberalization would be premature, because there are a lot of issues here on both sides, beginning with the fundamental question of why a foreign investor would be interested in making a large investment in a U.S. airline when U.S. citizens aren't interested. That goes to the question of motivations, which needs a full airing in a public forum such as this over the months ahead.

Also, EC–92. We want to make sure that we have a full package of things to negotiate with when EC–92 rolls around rather than giving out cabotage rights at the present time.

Mr. MINETA. If we allow this increase, as the Secretary has promulgated, up to the 49 percent, and then you look at the Government participation in the ownership of foreign airlines, I really wonder then what is our stance? Especially, it's a national security issue, and so whether it's Air Jamaica that's 100 percent government-owned or Air Italia, which is 83 percent government-owned, SAS 50 percent government-owned, or even this last airline here, Mr. Chairman, Iraqi Airlines, 100 percent government-owned, I just don't think we ought to be going down that route in terms of trying to find that as a solution for the problems of the airlines.

Mr. MEAD. I would look very closely at the foreign issue. There are three prongs of it that deserve intense scrutiny, and the first is competition. Will this really promote competition? Will the transaction in question be competitively good on an international level or on the domestic level? Second is national defense considerations, and third is reciprocity to make sure that the U.S. carriers get a fair shake——

Mr. MINETA. We don't have market access to a lot of these markets in countries that want to come in and invest in our airlines. To me that just doesn't make any sense, that we should allow them to come in and play in our economic sand lot and we don't have that same opportunity to play in their economic sand lot.

Well, again, Mr. Mead, let me again thank you. Over the years, you at GAO and your team have been always so thorough and good in your work, and I just want to commend you again for another fine piece in terms of the testimony here, and I may end up with some more questions that I'd like to send to you after going over the testimony.

Mr. **Mead**. We'll be glad, as always.

Mr. **Mineta**. Thank you very much, Mr. Chairman.

Mr. **Oberstar**. Mr. Nichols?

Mr. **Nichols**. Mr. Chairman, I just want to thank the GAO, too, for these comments and the fact that it's tremendously important not only to the Nation but to the state I represent, where Wichita, Kansas, has a lot of aircraft and airline industry. We need to get a better handle on this, and we appreciate this opportunity to get involved in this and have more detail.

As this situation goes along and the airlines get weaker and weaker, the question does come up, "How many will be left at the end of this shake-out?" Do you have any kind of a prediction?

Mr. **Mead**. It's a common question this morning, Congressman. Secretary Skinner yesterday said he projects a range of three to seven, as I understood his testimony. I deeply hope that the Nation does not face a situation where they try to have deregulation and try to promote it in a framework of two or three carriers. That will be very difficult, given the concentrations in some markets, so I hope that doesn't happen. I'm not in the business of prognosticating how many will be left; I don't think, though, that five or six is outside the realm of probability.

Some of these situations are too far along for some of the carriers to do much about. You hate to see some of these airlines go under, but as the Chairman was saying earlier, this has been brought on by the acquisition of extraordinary levels of debt, even for the airline industry, which seems to have a higher tolerance level for debt than anybody else. How do you survive? It's like the Federal Government's budget deficits.

Mr. **Nichols**. Very good. I understand that's a very difficult question, and I think that prognostication is fair enough. Of course, we're all for those that are struggling to get them on their feet, but we wonder how much effort, how much finances and how much economic support can be put into them. Thanks a lot.

Mr. **Oberstar**. Thank you very much, Mr. Mead, and all of your associates. Mr. Clinger has a few other questions. Then I will conclude with some questions for the record that I want you to not answer here but submit in writing, but Mr. Clinger is recognized.

Mr. **Clinger**. Just following on what Mr. Nichols said and some of them earlier trying to pry out of you some predictions on the number of survivors, isn't the issue here the number of survivors we have, that there be adequate competition in the industry? It seems to me that if we have seven or 10 survivors and they don't choose to compete head to head in the city pair markets, we haven't really accomplished very much. It seems to me that the concern of this committee ought to be how do we encourage new entries, new players, but certainly to encourage somehow competition.

Now, the access we've talked about. I think that moves us in the right direction. The PFCs, as you've indicated, are going to take some time but ultimately are going to get there. We're going to have more access and more ability to handle a number of players, but just to say "Well, we've got to preserve so many airlines to keep competition" I think sort of begs the point.

Mr. MEAD. That's a very eloquent wrap-up; it puts in the right contextual framework the essence of our points here, that even five carriers won't be enough if a set of oligopolies form a territorial cartel around the country. We've been talking about these issues for two or three years now—that is, we were moving more and more toward a less competitive environment, and that we think the events with the recession and the Persian Gulf crisis simply brought things on sooner than otherwise would have been the case.

But that's an eloquent wrap on it. The focus has to be on having an even playing field for the competitors that remain, and in many respects we don't have one now, and it behooves us all to be even more vigilant, given the financial stress on this industry.

Mr. CLINGER. I think that's sufficient. I was just going to say that one of the things that it's been the testimony here over the last couple of days that it would be very difficult for a new airline to start up, given the enormous capital requirements that are involved in new start-ups, and yet it seems to me that it might be the new entries that would be more inclined to get into a competitive situation, which is, I guess, why I have been interested in exploring the foreign capital possibility as another source.

I would just perhaps encourage Mr. Mineta to take a look at my bill, because it does provide very stringent requirements on reciprocity, you know, that we would not be allowing investments here that did not permit the same sort of investments in those foreign countries. But I think capital is going to remain a problem here, and we've got to find some ways to develop more of it. Thank you.

Mr. MEAD. Let me just respond to the foreign issue. There is one angle that I'd like to emphasize that really hasn't surfaced in the public debate to a great degree, and that is, that if we're going to have a competitive system, and if we truly are—and I believe we are—headed toward a more globalized industry, then doesn't it behoove us also to scrutinize the competitive results internationally?

For example, you'll hear more in the coming months about alliances that the U.S. carriers will form with a foreign carrier so that the U.S. carrier that gets a landing right may agree to feed its traffic to a foreign carrier. What does that do, I would query, to the competitive situation in that particular market? What does that do to another U.S. carrier that's trying to compete internationally? What does that do to other foreign carriers that might be competing?

Some of the problems we're experiencing domestically in the competitive arena could well be transported overseas if we're not very circumspect.

Mr. CLINGER. Just one final note for the record. Some of us took some heat last year in working on the LBO bill, which, as you know, did not become law but which I do think had an influence on perhaps preventing some, and particularly in the United and American situation may have forestalled those. Would you care to speculate on what condition American and United might be in had those leveraged buyouts gone forward? In other words, wouldn't they have somewhat the same problems that we see with the other carriers with enormous debt burdens to deal with? I guess I'm just seeking some vindication for the efforts that we made last year.

Mr. OBERSTAR. I join the gentleman in seeking vindication.

Mr. MEAD. Well, I think it certainly sets the tone that the Administration was mindful of and I think the aviation community was mindful of. It's interesting to take the history of some of these airlines, and look at American's situation. They didn't get caught up in the merger game in the mid-1980s, and they seem to be one of the healthier carriers today. I look at their debt-to-capitalization ratio, and it's somewhere in the neighborhood of 35 to 40 percent, and while to some that might seem high, it's certainly low and modest in relationship to some of the others that you're reading about in the paper as being financially troubled.

Mr. OBERSTAR. A few questions for you to respond for the record.

First, what relationship is there in fare discounting to real head-to-head competition? I have a suspicion that fare discounting goes on for purposes other than competition, but it would be interesting if you could develop for us charts on major markets where there is real head-to-head competition where fare discounting has occurred.

Mr. MINETA. Mr. Chairman?

Mr. OBERSTAR. I'll recognize the gentleman in just a moment.

I'd like you to develop a chart, if you will, demonstrating the rise and fall of competition in key city pair markets, both hub and nonhub, as an indication of where this airline industry is going, where competition and service is going as carriers drop out of the picture. I think you could probably do that over the last decade as carriers entered, dropped off, were acquired, and what happened to competition in city pairs.

Finally, Mr. Cherlow, I really don't want to prolong the session here by having you expand upon the experience with the Conrail, New York City and Lockheed rescue efforts, but should such an effort be contemplated for the airline industry, I think your comments on one very abbreviated page reference to that history and several points of counsel for the future on how to address on a policy basis the question of a rescue for the airline industry are very instructive, and I think there is probably some meat you can put on those bones to help us think this through.

Mr. Mineta?

Mr. MINETA. Mr. Chairman, I apologize for interrupting, but I'm wondering if you would consider adding another one to that list. I'd like to find out about the practice of rebates, the airline rebating to—not rebating—rebating on the international, I guess, but higher commission rates being paid by airlines to travel agents and whether or not that isn't tilting, and the ability of the 800-pound gorilla to increase, let's say, the commission rate to a travel agent if they will give them a million dollars of business or "If you will give me 85 percent of your traffic between San Francisco and New York, I will give you an increased commission rate on tickets versus, you know, another start-up carrier that wouldn't have that ability to do that." Do you think that would fit in with your inquiry, Mr. Chairman?

Mr. OBERSTAR. Yes, it certainly would. It would be very good. There was a whole section on CRS in the GAO statement that addresses those matters very thoroughly, which you addressed in extensive hearings some years ago, and I think it would be very appropriate to include that.

Mr. **Mineta**. Thank you, Mr. Chairman.

Mr. **Mead**. I think we can respond to all those questions.

Before you let us go here, I wanted to point out an area that is worthy for this subcommittee to probe and that's germane to this issue.

Last year there was quite a bit of discussion about what to do with the aging aircraft fleet. Your legislation set a tone and received a response from FAA, even though you didn't have to make it into a law. FAA set up a time line for repairing all the aging aircraft. I would suggest that if you look at the composition of the fleets of the carriers that are in a financially weaker condition, that will raise some questions in your minds about how promptly they're going to meet the deadline for making those repairs and where the money is going to come from.

Some of these numbers I have in front of me suggest that 35, 40 percent of the fleet is over 20 years old, so they're clearly affected by that set of rules. We'll be addressing some of these issues in a report to you fairly soon on repair station capacity in the industry.

Mr. **Oberstar**. Thank you.

Mr. **Mulvey**. One final point. The committee will be interested in knowing that today we released a study of airline fares and concentration at small city airports, which is part of a series of studies we're doing on airline fares. I think it's germane to some of the points Congressman Clinger raised and which Congressman Dorgan raised in his earlier testimony.

Mr. **Oberstar**. Thank you for advising us of that report coming out, and we'll look forward to reading it. Your comments on aging aircraft are very much appropriate. We intend to move that legislation again this year.

Thank you very much for being with us this morning, a very long morning, for your patience, and for your very sound counsel.

[Mr. Mead's prepared statement appears on p. 550.]

Mr. **Oberstar**. Next is the Air Transport Association, presented by Mr. James Landry, Senior Vice President.

Welcome, Mr. Landry. We're glad to have you with us this morning. You heard yesterday's testimony and today's testimony, and I know you've got a very extensive document of your own to submit for the record, and we will include your printed statement in full, and you may summarize as you desire. You've made a very comprehensive presentation.

TESTIMONY OF JAMES LANDRY, SENIOR VICE PRESIDENT, AIR TRANSPORT ASSOCIATION OF AMERICA

Mr. **Landry**. Thank you, Mr. Chairman. I will, of course, summarize my statement.

Mr. Chairman, members of the subcommittee, my name is Jim Landry, and I'm Senior Vice President and General Counsel of the Air Transport Association. We appreciate this opportunity to explore the financial outlook of the U.S. airline industry and we earnestly hope to begin to chart the appropriate course of the U.S. Government's aviation policy for the 1990s.

One short month into a new decade which many felt was destined to be the most challenging and rewarding period in aviation history, the industry ironically must look back on 1990 as its worst financial year in history and look forward to no change in these grim results, at least in the near future.

You all know the fundamental causes of our downturn—soaring jet fuel prices, the recession, the war. Hopefully, 1991 will see an end to all three of those overwhelming factors. If it does, we will not repeat last year's record net loss of more than $2 billion. If it does not, the industry's financial devastation will continue.

This, of course, is not the forum for dealing with those three horsemen, and so the fourth, the Federal Government's exacerbation of our situation, through action and inaction, will be the focus of my brief remarks here today.

As I spell out in some detail in my prepared statement, we're tired of being perceived as a willing cash cow for Federal revenue raising. The amount of Federal tax on an airline ticket has increased 81 percent in the last 10 years. Airline prices unadjusted for inflation have increased only 12 percent in that period. Tax increases adopted last year alone represent an additional $12 billion burden on aviation over the next five years, with most of that money earmarked for deficit reduction rather than aviation infrastructure improvements.

Mr. Chairman, 12 years ago when Congress overwhelmingly voted for airline deregulation, it was decreed that we would be a vehicle of mass transportation and that we would achieve that goal by offering a great variety of low-priced services. We have kept our part of that bargain. Discounts are the rule, not the exception. But we and the Government seem to be working at cross purposes. The aggregate effect of the taxes and fees imposed has been to make commercial air transportation appreciably more expensive. That reduces demand for our services and deepens our losses. We ask Congress and the Administration to stop treating flying, along with smoking and drinking, as a third target for sin taxes.

The new Federal noise regulations mean that more than half the U.S. fleet over the next decade either must be retired or significantly modified to make them quieter. While, as some of yesterday's testimony revealed, there is still not unanimity regarding the timing, we support the basic mandate—so long as a single set of rules applies to the whole national system, and we're not obliged to cope with a patchwork quilt of local restrictions immune from essential Federal oversight. We do ask you to keep in mind, however, that this has in large part triggered an airline commitment of over $120 billion to replace older aircraft and expand their fleets.

Recent Federal security requirements imposed only on U.S. airlines and therefore maximizing protection for only half of our citizens flying internationally make it more difficult for U.S. airlines to compete with foreign airlines on overseas routes. We acknowledge that the Notice of Proposed Rulemaking issued on Monday by the FAA indicates some movement in the right direction.

The Federal Government has yet to make good on its promise to provide a modern, efficient air traffic control system, able to respond quickly to the burgeoning demands of the past and of the future. In 1990 there were more than 1,000 daily airline delays of

15 minutes or more, one-third of them the result of inefficiencies in the air traffic system. These delays added $2 billion to industry operating costs, coincidentally equaling the industry's record net loss for the year.

In short, we ask that in the 1990s the Federal Government do what it promised but failed to do in the 1980s—meet its aviation-related responsibilities. We cannot continue to manage our costs without the commitment of the Federal Government to conduct its aviation policies in a far more disciplined and effective way than it has done in the past.

Mr. Chairman, my prepared statement also summarizes the full facts of our deregulation experience in contrast to anecdotal or selective analytical evidence. And we touch upon some purely international matters in addition to the competitive burdens created by the DOT/FAA refusal to date to impose security requirements with an even hand. Specifically, we spell out our frustrations over the use of agriculture and immigration inspection fees, the increasingly harsh policies of the INS in particular, and the new, totally unjustified fee for the benefit of the U.S. Travel and Tourism Administration.

Lastly, we note our tentative agreement, not yet defined, that traditional restrictions upon the level of foreign ownership of U.S. airlines should be relaxed, and we urge Congress to act to extend the War Risk Insurance Program to enable coverage for domestic operations and to correct other practical shortcomings of the Title 13 formulation.

Thank you, Mr. Chairman. I'll be pleased to respond to any questions you and the other members of the committee might have.

Ms. HORN [assuming chair]. Thank you, Mr. Landry.

Mr. Clinger, the gentleman from Pennsylvania?

Mr. CLINGER. Thank you very much, Madam Chairman.

Mr. Landry, we thank you for your testimony and outlining the problems that the Association sees. You've got a lot of problems at this particular time.

Mr. LANDRY. We do indeed.

Mr. CLINGER. Hopefully, they will be of a temporary nature, and we will see you restored to health soon.

Just picking up on the last witness, Mr. Mead suggested that the subcommittee might want to look at what they perceive as a potential problem, which is to say that some of the weaker airlines presently operating will be unable to meet the deadlines established for the Aging Aircraft Retrofitting Program. Do you have any response to that? Would you concur with that? Do you think that is going to be a problem?

Mr. LANDRY. Well, obviously, with the shortage of capital at the present time, those carriers will face great difficulties. We do not yet have any specific proposal in that regard. I know that it was mentioned yesterday by one of the witnesses that perhaps the date is a bit premature. That was the view of that particular carrier. We have not polled our entire membership on that issue.

Mr. CLINGER. You raised the question about the fact that our Government has not required foreign carriers to impose the same kind of security requirements and that that is perceived as a competitive disadvantage for you, but it's my understanding that as a result of the Gulf crisis in fact there has been a substantial upgrading of security requirements by the foreign airlines. For example, British Air and Heathrow are basically requiring their passengers to go through the same kind of clearance procedures as the U.S. carriers. Is that your understanding?

Mr. LANDRY. I think that obviously there has been an enormous upgrading of security precautions worldwide in the current crisis. And, as I also mentioned in my oral statement a moment ago, we were also heartened by the fact that the FAA's Notice of Proposed Rulemaking issued on Monday at least indicated movement in the same direction—requiring foreign air carriers to submit their security plans for review by the FAA for a determination by the FAA that they were at least similar requirements or similar standards. We, of course, have urged the Congress and the FAA and the DOT that the requirements should really be identical in nature.

Mr. CLINGER. A lot of reference has been made over the last two days to the problem of capital formation for the airline industry, and there were additional points raised today by GAO having to do with the aging aircraft issue—the safety involvement, things that have perhaps been imposed on the industry by Congress or by the Administration that are costly and will require substantial new investments.

One of the major focuses of these hearings has been on the question of whether or not to consider foreign capital as a potential source of capital. Some legitimate questions were raised about the possibility of national security concerns, who is going to really own the airline, who is going to really be calling the shots, those kinds of issues, which obviously would have to be addressed. But as a general proposition, if sufficient safeguards could be built into the legislation, would the industry support allowing the infusion of foreign capital into your industry?

Mr. LANDRY. We have reached a tentative agreement that there should be a relaxation of the traditional restrictions on foreign ownership. We think an infusion of foreign capital is warranted. We have not yet reached a position on whether that requires legislation, as I know you have suggested, or whether it can be done, as Secretary Skinner has suggested, without any change in the existing statutes. I think it is absolutely clear that a sine qua non for any relaxation has to be reciprocity. We can't do this as a one-way street.

Mr. CLINGER. Well, that certainly is the thrust of my bill, which is to say there needs to be pro-competitive agreements with a country whose citizen is trying to invest over here and that we would have the same rights in that country that the foreign national would have in investing over here.

Mr. LANDRY. I would remind Mr. Clinger that the previous witness referred to some conversations with Mr. Sorenson over at the European Community, in the Commission. Mr. Sorenson, I'm sure everyone appreciates, is very fond of noting that while some individual member states of the 12 European Community states today have 25 percent rules, similar to our own 75 percent U.S. citizenship, that, as he puts it, "After EC-92 we are going scheduled to be twice as liberal as you, because we are going to a simple majority rule." The majority of the ownership must be in the hands of citizens of the European Community. So they are moving in that direction, or at least that is their current plan.

Mr. CLINGER. My understanding, though, is that they still have a ways to go to get unanimity of agreement on what that directive is ultimately going to contain.

Mr. LANDRY. I believe that 1992 is am ambitious target year.

Mr. CLINGER. Just one other comment. There has been some sort of conflicting testimony, shall we say, as to the result of deregulation on overall fares, and it was my understanding that in terms of real dollars the fares were at or below what they would have been, say, the year before deregulation. Is that accurate?

Mr. LANDRY. They are indeed. Our own evidence is that they are in terms of real dollars 28 percent down. We have in our——

Mr. CLINGER. Would that be at the major hubs?

Mr. LANDRY. That is system-wide.

Mr. CLINGER. Okay. How about the hubs? Are they above or below where they might have been?

Mr. LANDRY. Well, there has been a great deal of analysis as to what is taking place with regard to the origin and destination traffic at major hubs; however, one fact of life that everybody agrees on is that in pairs of points where there is inter-hub competition, the advantages, the discounting, the drop in prices is quite the same as it is system-wide.

Of course, the studies have concentrated on the origin and destination traffic at the major hubs, and that involves a lot of factors, such as the demographics of the market—some of them are heavy in business traffic—and the short stage length that the bulk of the passengers in a lot of those major hubs fly. I think the proof is in the pudding. There are communities and airports all over this Nation that frankly would love to be hubs. What comes out of it is a tremendous amount of service for the people who live in those hubs. They have better service than people anyplace else in the country.

Mr. CLINGER. I think you're right. I mean, I think a hub turns out to be a major economic development asset to the community, and perhaps we ought to figure out some way to get the communities to help pay for them. Thank you very much, Mr. Landry.

Mr. LANDRY. Thank you, Mr. Clinger.

Ms. OBERSTAR [resuming chair]. Mr. Mineta?

Mr. MINETA. Thank you very much, Mr. Chairman.

Mr. Landry, I always enjoy your presentations before us, and I'd like to ask about, on page 17, your reference to INS. You say "Despite specific language in the fee provisions to the contrary, we continue to be charged with the detention of inadmissible passengers." I was wondering if you could expand on that for me, please.

Mr. LANDRY. What is happening, Mr. Mineta, is that despite the best efforts that our staff, our airline personnel are making—and they're really trying very hard—there are passengers who end up coming to this country without proper documentation. I might say that some of them present what appears to be proper documentation at the counter when they are embarking and then get rid of them sometime before they arrive in this country. They disappear. They flush them down aircraft toilets. All kinds of things are happening, and those people come in, claim asylum, and there are a number of cases where unfortunately, in spite of what the law said, this is still being done where they're being detained at enormous airline cost.

Mr. MINETA. Where is that airline cost? I guess that's the part I don't understand. Where does the airline get stuck with the cost of someone who had proper credentials, gets boarded and then disposes of them, and then INS says, "Okay, I'm sorry, you can't come into this country"? Where does XYZ Airline then have to—what's their responsibility at that point?

Mr. LANDRY. It's when those inadmissible aliens have claimed asylum and are awaiting hearings for admission to this country. There are a number of instances where the cost of putting them up in hotels, and down through the years of even hiring guards to make sure those people stay in those rooms, is borne by the airlines, and that has not been——

Mr. MINETA. Frankly, at that point, if they're inadmissible and the Immigration people are saying, "No, you can't come in," why can't you just troop them back on a plane that's going out the next day or later that night?

Mr. LANDRY. They're claiming asylum, and they're given their due process. The only problem is we bear the cost of the due process.

Mr. MINETA. But even if they're claiming asylum, I guess I don't understand why that becomes the responsibility of Pan Am or TWA.

Mr. LANDRY. We don't, either.

Mr. MINETA. Is that the law?

Mr. LANDRY. That is the practice. You did identify another possibility, but that doesn't prove to be possible in many instances, and that is to board them on the aircraft and take them back from whence they came at airline expense.

Mr. MINETA. Well, if that's just a practice, it seems to me I've heard that there are a lot of seats available for European-bound flights. I don't know why you can't just troop them back on and send them back, if it's a practice. I'd like to pursue this with the Chairman of this committee and with our own Immigration folks on that. I mean, it doesn't seem reasonable that the airline would be—I mean, you know, filet mignons and nice rooms?

Mr. LANDRY. It has never seemed reasonable to us. I should say that we have had guards murdered, we've had guards raped, we've had rape situations in both directions. Frankly, this has just been an enormous headache. The airline industry isn't equipped to perform law enforcement functions. We think it's wrong; that's why we went to get a change in the law. We thought we had it solved, but it's not solved.

There are other problems with what INS has been doing recently. Just yesterday they sent out a notice that would automatically repeal the transit without visa possibilities that we have enjoyed for many, many years. We thought we had reached a compromise with them so that at least a passenger coming in and wanting to stay in this country without a visa and leave from the same airport of entry as he or she came into would be allowed to continue to do that. However, yesterday, in a sudden emergency announcement, that possibility, which means about $150 million in revenue to the airlines annually, was suddenly removed.

Mr. **Mineta**. Let me ask about the war risk insurance. As you know, my background is insurance brokerage, and in 1975 I was, I think, instrumental in making the changes in Title 23 when we were trying to get everyone out of Vietnam at the very end. Are you having a problem with reinsurance?

Mr. **Landry**. There are gaps, Mr. Mineta, in the current coverage of Title 13. As you obviously will recall better than any of us, when that was——

Mr. **Mineta**. Well, I remember working with Mr. Tippet from Pan Am around the clock because those planes were sitting in the Philippines and in Guam ready to go into Vietnam, but they had no insurance coverage, and I remember we got some legislation passed here very quickly for Title 13—I'm sorry, not Title 23—to allow those planes to go into Vietnam to pull everyone out before the fall of Vietnam in April of 1975.

Mr. **Landry**. Well, when that was done, it was obviously aimed at that very specific and very major problem. At that time, I'm sure no one dreamed that we could also have threats of the possibility of acts of terrorism against aviation here in the United States which might trigger here in the United States enormous increases in our insurance premiums. Or indeed that some circumstances, some event could trigger the cancellation of war risk insurance worldwide, and that would mean that we would not have war risk insurance for domestic operations, either. What we're suggesting is, let's fill that gap to provide for coverage for domestic war risk insurance.

Mr. **Mineta**. Without taking any further time, I'd like to pursue that, Mr. Landry. I'd like to just make a comment, and that is I hope that members of your association do not follow, frankly, Northwest's lead on trying to cover their operational costs with this flat fee which they're dubbing for and trying to give the Persian Gulf crisis as a reason for their raising their fares or ticketing charges, because I really think—recognizing they have to have a source of income or increase their fares, but I think to tag it on that basis, I think, is a little disingenuous.

Mr. **Landry**. I would say, Mr. Mineta, that I just read of that, but one of the things that accounts for my longevity is to stay out of the fare business.

Mr. **Mineta**. I understand. I understand. The other thing, too, is I've heard so much talk about labor costs, but I don't appreciate a lot of this talk about how much airline pilots or flight attendants or mechanics and others are being paid when we also have chief executive officers with very nice parachutes, and when I think of one executive who tried to walk off with $70 million, as I recall the figure on this whole issue, in an LBO situation—and it failed, because I think the bankers themselves decided they didn't want to finance one individual making that much and walking away from it—I just hope that—you know, you're a service industry. You require good people. You have good people.

So I just don't like to see this constant bickering about the value of employees. I mean, we have valuable employees in the U.S. Government. People who pick on Civil Service employees or staffs of legislative—I just don't appreciate it, especially given the fact that some CEOs have very lucrative parachutes. So I just hope ATA doesn't go down this line. Thank you very much again, Mr. Landry.

Thank you, Mr. Chairman.

Mr. **Oberstar.** Mr. Geren?

Mr. **Geren.** Mr. Mineta made a great introduction to my question, and bearing all his comments in mind, I wanted to ask you to comment some on the labor situation. You know, we have heard a great deal about the labor costs threatening the international competitiveness of our air industry, and I would like you to discuss that for a moment if you would.

Mr. **Landry.** Well, the Secretary of Transportation has obviously raised the issue again yesterday in his testimony and in recent speeches. With regard to the salaries paid to our employees, many witnesses here have pointed out the differences in work rules, the productivity that is required from various employees by various carriers, the striking differences in wages paid by different carriers, and so forth.

I think all of that requires a lot of sophisticated analysis and consideration that we haven't done yet. We are embarking on, because of the repeated references to the Railway Labor Act and whether it is suitable law for governance over the airline industry in 1991, a full scale review of that question once again. We had done it before, we're doing it now, and when the issue comes before this and other committees, I hope we'll be prepared to address it.

Mr. **Geren.** All right. After Mr. Mineta's comments, I didn't expect you to go any further out on a limb than that. Let me ask you one other question. We do talk about foreign investment, and it seems some hold that out as one of the solutions to the financial problems we face. Mr. Mead brought up an interesting point, I thought, of why do we have hope that foreign investors would find this a more attractive investment than domestic investors, and is it that we see them to have different investment objectives, a longer term view, or whatever? Why do we see this as offering us some way out of our financing problems?

Mr. **Landry.** Experts at least believe that there is the possibility of an infusion of foreign capital. We frankly have had such a track record in terms of net profit margins and so forth down through the years that we have had great difficulty in recent years in attracting large amounts of American capital. The suggestions, I think, certainly deserve consideration that perhaps the traditional restrictions should be relaxed to see if there is foreign capital out there. Again, I think we've got to insist on reciprocity. We can't have this purely—what I understand has been talked about here for a couple of days now—back door cabotage without some quid pro quo for the U.S. and the U.S. carriers. We don't want this to worsen our situation, but we do believe that some relaxation is in order.

It's a worldwide trend as you go into a globalizing industry. You're going to have multi-national carriers down that road. We also have to recognize that we have played an enormously important part in Operation Desert Storm in getting the personnel and equipment over there, and we can't ever leave ourselves in a position where we can't continue to be, what back in World War II—I was reading the history books—was referred to as an "auxiliary air force." We still are that.

Mr. GEREN. If I could follow up on that just briefly, what is the evidence that—other than, I guess, it does certainly enlarge the pool of capital available, are there investment objectives in other parts of the world that are different than ours? What makes us have the hope that this would result in a significant infusion of capital?

The reason I raise this is, you know, are they different types of investors? Are we looking to attract the investment from other governments? Would that be one of our hopes? Why would a financier in Italy have more of an interest in owning TWA stock than a financier in New York City? Because if we're just looking at traditional institutional investors, why would there be any difference there? The only real different investor I see out there is the possibility of foreign governments through some vehicle, either through their own airlines investing in our domestic industry—I guess my question is what gives us any reasonable hope that this would attract a significant pool of new money?

Mr. LANDRY. I think one thing that I ought to make clear right here is that the tentative agreement among our members which suggested that a relaxation was in order, whether it be statutory or Secretary Skinner's way, without a change in the statute—we haven't taken a position on that as yet—has two caveats: One, that there be reciprocity, and the other, that the same degree of relaxation at least not be accorded foreign government capital flowing in. We are talking about private capital. We do not have a desire to have our U.S. airlines owned or controlled by foreign governments.

Mr. GEREN. All right. Thank you for your comments and your responses.

Mr. Chairman, I have no other questions.

Mr. OBERSTAR. Would you take that last one step further—foreign government capital investing in U.S. carriers indirectly through foreign government-owned or controlled carriers?

Mr. LANDRY. We would take that one step further, yes. The specific condition was that we are not looking for such investments by state-owned carriers.

Mr. OBERSTAR. Very good. You referred to the tax increases that were enacted last year, and you say that "Competitive pressures will force airlines to absorb most of the tax increases rather than recouping them from customers." Supposing the 2 percent additional ticket tax that was included in the reconciliation bill last session against my very strong objections——

Mr. LANDRY. And ours.

Mr. OBERSTAR. and the industry's, yes—were lifted temporarily, at least through the duration of the Persian Gulf crisis and through the period of the recession. Would the airlines, thus relieved of the new tax, reduce fares to a point where they might not get the benefits contemplated? Would they continue to charge current fares so that concomitantly there might not be relief for the traveling public? What would be the industry's response?

Mr. LANDRY. It would be individual carrier responses, and my crystal ball wouldn't be able to forecast what each individual carrier would do. There has been some conjecture here that some might pass that money on to the traveling public. I don't know. I do know that we are hemorrhaging right now. We lost $1.7 billion in the fourth quarter last year. We were struck that, in that same fourth quarter, the oil industry in this country earned as much profit as we have in the last 10 years, so I don't know just how far people would go in saying "Let's give that money back."

Mr. **Oberstar**. Well, I have never understood why your industry did not lead a march down Pennsylvania Avenue to the White House, clamor at the gate for tough anti-trust action by the Justice Department on those speculators in oil futures who drove the price up when there was no shortage of oil in the real world, in the marketplace; and secondly, why you didn't clamor for a windfall profits tax as a means of, one, staving off those horrible price increases, and two, recouping something for the industry should any price go up. The industry, it seemed to me, was terribly timid. It made pronouncements about the dire effects but did nothing visibly to persuade this Administration to take some tough action.

Now, you weren't the only industry affected by those increases but the one that was disproportionately—testimony from the airlines yesterday—disproportionately hit by the increase in fuel prices. I think the testimony was very revealing that prices for jet fuel went up more than twice the rate of motor fuel.

Mr. **Landry**. The testimony was very accurate, and I will say that we did march en masse on the Secretary of Transportation, Mr. Skinner, and the Secretary of Energy, Mr. Watkins, we talked to people at the White House, and we even went so far as to pass on all the information to the Department of Justice to the Anti-Trust Division, so everybody is fully aware of the inordinate burden placed on the airline industries, the consumers of jet fuel, as opposed to other refined products. I think, frankly, that when the President, after August 23, talked to the oil companies and jawboned them to take it easy on the consumers, they translated that into the consumers at the gas pump, and they decided that obviously there are some other consumers that aren't going to squeal quite as loudly.

Mr. **Oberstar**. Well, I just think the Government response was abysmal, to say the least. On war risk insurance, there is another subject that I think the Government response has been very puzzling. There are cases in which, driven by OMB, the State Department was willing to approve war risk insurance for hull and crew but not passengers from the U.S. to the Middle East—Tel Aviv—but for hull, crew and passengers out of the Middle East to the U.S. on the principle that we don't want to load up the zone with more targets for terrorism, i.e. U.S. citizens coming into the Middle East.

But the flaw in the theory was that the passengers in were subsidizing the passengers out, or at least making it possible for them to fly out at an economical fare, and secondly, when I raised that point with—and I won't mention all the players that I raised it with throughout the Administration—it was that "Oh, there's plenty of capacity to carry passengers in from other carriers," I said, "Wonderful. You're handing the Europeans and other carriers a major slice of the U.S. business by saying 'Go ahead, you carry'"—their governments are providing the insurance for hull, crew and passengers, and we aren't.

So a deliberate policy of Government is giving a competitive advantage to the very folks who have their hand in our pocket already.

Mr. LANDRY. I would point out, Mr. Chairman, that the commercial market in this instance, at least in this time period, has been flagged blind. They have raised the premiums, the commercial market, for carriers of all flags to those destinations. The thing that we are up here suggesting that Congress ought to move to legislate about is to fill a gap that also is created by boilerplate provisions in commercial insurance contracts worldwide, and that is that right now they are down to 48-hour cancellation notices instead of seven days so that you can have a very dramatic increase in premiums for domestic war risk insurance, for example, in a two-day period.

You also have either of two events that would automatically cancel war risk insurance, domestic and international worldwide, should either of those events occur. We're not expecting those events to occur, but we sure would like to see legislation in place so that should the unthinkable happen, we would like to be able to continue to operate. We cannot operate without insurance.

Mr. OBERSTAR. What types of risks for domestic service would be covered by commercial war risk insurance, typically?

Mr. LANDRY. Well, right now they cover all war risk insurance wherever the operations take place, but the——

Mr. OBERSTAR. But domestic U.S.

Mr. LANDRY. Domestic is included. Acts of terrorism by the commercial war risk contracts in existence are covered. We certainly have a number of messages that should those contracts be cancelled by either of two events or at 48-hour notice—either of two events would be automatic and immediate, and 48-hour notice is at their will at this point in time—that when they are reintroduced, a number of rumblings have suggested that they might exclude acts of terrorism in future commercial contracts.

That's why we say let's have Title 13 insurance available not just for operations in foreign air commerce and operations between two foreign points, which is the case today, but also available for domestic operations and also somehow to be an automatic coverage so that it is triggered to cover a flight that may be in mid-air should it be cancelled by one of these events off in some foreign field. We want something to get in place automatically to cover us, and then there are some other problems perhaps with regard to the standards that ought to be applied in judging whether domestic war risk insurance should be made available in the case of premium fluctuations and so forth.

Mr. OBERSTAR. Well, that's a matter that I think needs further refinement and clarification and perhaps some specificity as to the types of circumstances under which the insurance might be provided, and we'll be very much interested in working further with the industry on this matter.

Mr. LANDRY. We'll be very happy to work with your staff and anyone else that you designate on that problem.

Mr. OBERSTAR. Thank you very much, Mr. Landry. We greatly appreciate your presentation.

Mr. LANDRY. Thank you.

[Mr. Landry's prepared statement appears on p. 502.]

Mr. OBERSTAR. The committee will stand in recess until 1:30.

[Whereupon, at 12:30 p.m., the subcommittee recessed, to reconvene at 1:30 p.m., the same day.]

AFTERNOON SESSION

Mr. OBERSTAR. The subcommittee will come to order.

This afternoon we will continue with our panel of investment analysts, beginning with Ms. Helane Becker of Lehman Brothers; Mr. Timothy Pettee, Vice President, Alliance Capital Management; and Mr. Philip Baggaley, Senior Vice President, Standard & Poor.

Ms. Becker, please.

TESTIMONY OF HELANE BECKER OF LEHMAN BROTHERS; TIMOTHY PETTEE, VICE PRESIDENT, ALLIANCE CAPITAL MANAGEMENT; AND PHILIP BAGGALEY, SENIOR VICE PRESIDENT, STANDARD & POOR CORP.

Ms. BECKER. Thank you, Mr. Chairman.

Good afternoon, Mr. Chairman and members of the subcommittee. My name is Helane Becker, and I am Executive Vice President and Head of the Transportation Research Group at Lehman Brothers, with a specific expertise in the airline industry. I appreciate the opportunity to appear before you this afternoon to discuss the financial condition of the industry, and I would ask that my remarks be entered into the record.

I'd like to begin by saying that the financial condition of the airline industry is quite pitiful. The industry has been in a recession for the last 18 months. We think it will remain in a recession for at least the next six months, probably the next nine months. In line with this, the U.S. airline industry, on a net basis, lost between $1.5 billion and $2 billion dollars in the 1990 fourth quarter alone. With the numbers that have been reported so far, the actual operating loss is $1.2 billion, and the actual net loss is just over $800 million. We still have the worst of the airlines to go that will report.

Those numbers followed five prior quarters of consistently poor year-to-year earnings comparisons, with the last positive comparison the second quarter of 1989 compared to the second quarter of 1988. The first up year-over-year comparison we expect is the third quarter of 1991. We estimate following the fourth quarter record loss that the first quarter loss will narrow to $700 million, and for the second quarter we're estimating a further loss of $300 million for the industry. The fourth quarter 1991 comparison should be easy. We expect 1992 to be a better year with a cyclical peak in 1993.

The airline industry consistently manages to price below cost. We believe there is nothing on the horizon at this point to suggest this will change. There are just two differences we expect to occur in 1992 that won't be there in 1990 or 1991. One is lower fuel costs, and the other is an improving economy.

Airline companies will continue to sell assets; if they don't, they'll fail. Two airlines are currently operating in bankruptcy, even though three had been. One is liquidating. Of the two left, we expect Pan Am will be liquidated. With the Persian Gulf war, business travelers have cancelled off-shore trips, with the cancellations being especially pronounced in Europe. A lot of major U.S. corporations have actually used the situation in the Persian Gulf to rethink corporate travel policies. Unless Pan Am can generate revenue faster than it spends money in the next couple of weeks, we expect it to be liquidated. Other airlines we currently worry about include TWA, Midway, Hawaiian, Aloha, Northwest, U.S. Air, and America West.

The primary reason the industry did so poorly in the fourth quarter was the cost of jet fuel. The industry currently utilizes 16 billion gallons of fuel annually in flying. Every penny change in the price of fuel is equivalent to $160 million for the industry. The fourth quarter average price was $1.10 a gallon, up from 57 cents in the third quarter. That change increased the annual fuel bill of the industry by $8.5 billion to $17 billion.

Mr. Chairman, there is absolutely no way the industry can raise fares to cover that cost increase. Of greater concern is the fact that the price of oil and jet fuel has not yet stabilized, although it has come down quite dramatically.

A second reason the industry did so poorly last year is the weak economic environment. No matter what anyone says, airlines are cyclical. When the economy turns down, so does traffic. Furthermore, many companies cut travel budgets, implying continued weak traffic, and this continued into the first quarter. We expect the economy will continue to be a major problem through the third quarter of this year.

Our economic forecast at Lehman Brothers is that GNP will actually decline by 0.8 percent in 1991, following an increase of 0.9 percent in 1990. Traffic is expected to remain under pressure. For 1992 our preliminary GNP forecast is actually for an increase of 3.7 percent, suggesting the industry will recover next year. Actually, we expect the pain to be very great in 1991. There are 490,000 airline industry employees. Actually, there are less than that at this point. There were 500,000 at the end of 1989, and so far 33,000 have been terminated. In the next cycle, we expect 1993 to be the peak.

At Lehman Brothers, we believe in the marketplace solution to the industry's problems. Fewer airline companies does not necessarily mean a decline in competition. When a traveler in Hartford, for example, wants to go to Los Angeles, he or she can't go nonstop. A connection has to be made. Right now the connections can be made in Atlanta, Philadelphia, Pittsburgh, Detroit, Chicago, Nashville, Dallas, St. Louis, Newark, and Denver, among others, and I'm sure I forgot some. That doesn't suggest an oligopoly. Connecting complexes ensure competition.

Furthermore, in our opinion, we believe that fewer U.S. airline companies will be much tougher competitors for foreign airlines. Nowadays it's not enough to think domestically. Airline company managements must think globally, because that's where the competition is going to come from.

We are of the opinion at Lehman that there will always be discount fares available to travelers. It's up to the airline industry to manage revenue on board aircraft. It suggests a mix of low fare paying passengers, high fare paying passengers, as well as increased focus on belly cargo. Discounts, in our opinion, will continue to be a major pricing tool for the airline industry.

As mentioned earlier, we think the marketplace solution is the only answer to ensuring a vibrant, competitive industry and that the Government should not re-regulate the air transportation industry, but instead should perhaps focus its attention on deregulating the airport system, which was not deregulated at the point airlines were. Airports are already overcrowded. It's a perennial problem of growth. The problem in the industry at this point is limited airside and landside access to airports. The industry, together with the FAA, the Department of Transportation, and local communities need to address this issue quickly.

To speak to the issue of foreign ownership, foreign ownership has been the trend in the airline industry since 1987. In my prepared remarks on page 4, I have a chart showing all the marketing and cross-ownership agreements that the worldwide industry has managed to negotiate since 1987. We have long felt that view would continue into the 1990s. The pressure to raise the foreign ownership limitations comes from the weaker U.S. airlines.

It's our opinion that access to capital is a key issue of survival in the 1990s. Funding a capital spending program currently estimated at $160 billion over the next 10 years is a major issue the industry must face. In our opinion, access to capital is going to be the critical issue in 1991 through 1994. The only way there will be enough capital available for all airlines is if creditors can be somehow assured that they will be repaid.

The weakest U.S. airline companies will probably be first in line to sell equity to off-shore investors. This will keep weak airline companies in business perhaps longer than they should be. In the specific instance of KLM and Northwest, without KLM's interest Wings Holdings would have been unsuccessful in their bid to take Northwest private. Furthermore, ownership percentage is not particularly relevant. It's our opinion that voting ownership is key and that the current plan would still keep voting ownership below 25 percent.

In the last few years, many U.S. corporations have had access cash flow. We call these non-traditional lenders. Some of them actually set up subsidiaries to do what's called tax based financing. As corporate earnings come under pressure in 1991 and beyond, there will be less cash available for airline companies to do leveraged leasing. Furthermore, these non-traditional lenders are paying more attention to the credit quality of the airline seeking to borrow funds. The plane to be financed becomes important. There are 2,500 aircraft that do not currently meet Stage 2 noise requirements in the United States that are likely to be retired this decade. That's out of the U.S. industry fleet of 6,400.

We'd like to point out at this time that there is a major difference between foreign ownership and cabotage. They're two separate issues. We don't believe cabotage rights will be quickly granted. Worldwide, many airlines are having difficulty enforcing rules already granted in prior by lateral negotiations. Self-handling, for example, at international airports is one of the biggest issues that U.S. airline companies have difficulty resolving. The week of January 14, another issue—a six-month airport access issue at Narita Airport in Tokyo for UPS and United—was finally resolved.

I think there are two likely trials for increasing access to both U.S. and foreign markets. The first is likely to be in the current round of bilateral negotiations between the U.S. and Canada, and the potential for free trade between in fact the U.S., Canada, and Mexico. Moreover, the DOT should continue to permit weak airline companies to sell assets for international routes. International routes should actually be flown by the U.S. airline companies that can best maximize that traffic.

Chicago-London, for example, is far more valuable to American Airlines, with over 400 flights a day out of O'Hare, than it would ever be to TWA, with less than 60. There are other instances of this with Delta, United, Northwest, and others out of their hub locations.

The final issue I'd like to just touch on is the control of the computer reservation systems, which is still a critical element of traffic growth. On a worldwide basis, this industry is likely to consolidate, and in my prepared remarks on page 6, I show a chart of the way consolidation has already begun to occur. There are marketing agreements between European consortiums and U.S. CRS systems, and these are likely to eventually boil down to three or four CRS systems, down from the current eight. There are a host of company-specific systems like JALCOM and TRAVICOM, JALCOM being owned by JAL and TRAVICOM being owned by British Air, that will likely merge.

In conclusion, I would like to take this opportunity to reiterate our strong belief that additional regulation of the airline industry is not necessarily the right answer to today's problems. Regulation didn't necessarily work in the 1940 to 1978 period. Industry was originally deregulated for lower fares and improved service. The market forces should work. Governmental intervention would simply artificially distort the economics of the business and could easily lead to bigger problems in the future. The market should decide. It's the right answer for this industry. In fact, as I said earlier, the Government should consider looking at deregulating the airport industry.

Again, I'd like to take this opportunity to thank you for the opportunity to appear here, and I'd be glad to answer any questions.

Mr. OBERSTAR. We will have some questions. We appreciate your testimony very, very much, the very thoughtful points that you've raised here, and we will revisit it.

Mr. Pettee?

Mr. PETTEE. Thank you, Mr. Chairman and members and staff, for the invitation to address you today. I'd like to ask that my prepared remarks be entered into the record.

Mr. OBERSTAR. Without objection, all of the statements will be included in the record as printed, and you may summarize as you wish.

Mr. PETTEE. Summarizing, first of all, Mr. Chairman, I am a vice president with Alliance Capital Management. Alliance Capital Management is one of the largest pension and mutual fund managers in the financial services industry, with some $46 billion under management. A significant sum of that $46 billion is invested in

U.S. airline equities, foreign airline equities, as well as various U.S. airport instruments.

Mr. Chairman, I believe the airline industry is on the verge of a capital crisis. The impact of this crisis could curtail competition more so than even the high fuel prices that the industry is struggling with and even more so than the plummeting demand that the industry is struggling with.

The way, as I see it, to enhance competition in the airline industry is not by Governmental administration of fares and routes and other aspects of airline operations. The way to enhance competition in the airline industry is by enhancing the incentives for private capital investment, private sector investment in this industry which is in some cases starving for capital right now. It's in fact this lack of capital or the high cost of capital that is hindering the growth and hindering the development of competition in the airline industry.

We're all familiar with the events after deregulation. From a capital perspective, after deregulation capital flowed—indeed overflowed—into the airline industry. New entrants were met enthusiastically on Wall Street, new and used aircraft financing flourished with incentives such as the investment tax credit, and there were even guaranteed loans which provided some impetus for smaller carriers to get started. Indeed, during this period competition flourished.

Inevitably, some carriers and some ideas that never got off the ground failed, but the fact of the matter is that competition during this period was at its highest, and it flourished. It's that competition which has benefitted the American consumer with—I guess some have tried to put a number on it—but with certainly billions of dollars in savings, and that competition remains in part in the industry today.

However, as we speak, the industry is consolidating. Eastern is gone, and I certainly concur with Helane that I see little hope that Pan Am and perhaps other carriers can survive intact and/or independent of the current operating problems and lack of capital that the industry faces. Clearly, the economic forces are curing some of the excesses in the industry. However, it may not stop there. Further dramatic declines in traffic, transfers of wealth from the airline industry to the oil industry, and/or lack of gains in labor productivity—not necessarily pay, but productivity issues—and, in my opinion most importantly, further rises in the cost of capital for airline investments would perhaps force stronger carriers such as American and United, which are really the backbone and mainstay of the industry, to curtail, reduce or halt their capital—albeit ambitious—capital spending programs. This would limit growth, it would result in the shutting of regional hubs which we've begun to see in fact, and it would stifle the competitive instincts that a lot of these carriers have.

The U.S. airline industry in the 1990s hopes to spend $80 billion on aircraft. That excludes what they hope to spend if they exercise options with the various manufacturers. If you include the options, the figure is well over $120 billion on aircraft alone and another $20 billion on facilities to upgrade the decaying infrastructure. That's well over $100 billion that the industry plans to spend or hopes to spend in the 1990s. How is the industry going to accomplish this amidst what I perceive are some disincentives for capital markets to invest in the industry? Undoubtedly, the industry will look to finance this growth and these capital expenditures similar to the past—namely debt, leasing and equity capital.

I want to convey to each member of the committee, I want to convey to you, Mr. Chairman, that the capital market's debt, equity and leasing are troublesome right now, to say the least. Debt has been and will continue to be the most prevalent form of financing for the airline industry. It's a capital intensive industry, it's a leverage industry. In long term debt markets, however, the industry's woes have pushed the cost of capital up by some accounts 100 to 150 basis points relative to Treasury bills of late. Even stronger carriers, the Americans and Uniteds, will balk at financing long term debt at rates in excess of 10 percent or more.

Not to get bogged down in some of the issues, but in leasing markets there has been recent legislation, there is proposed legislation, coupled with the downturn in corporate profits which Helane alluded to, that has driven up the cost of capital, lowered the rates of return for lessors, and is damaging access to such financing, and lease financing was very, very important in the 1980s. Specifically, provisions in recent legislation altered the expected returns by lessors for aircraft used by U.S. carriers in international markets. The result—higher costs to airlines.

Further, the IRS is proposing to alter regulations regarding treatment of financial subsidiaries of regulated companies, such as telephones and utilities, which would deincentivize such companies from investing in new aircraft equipment transactions. This, together with a downturn in corporate profits, is serving to stun the appetite many corporations have for the equity portion of leveraged lease transactions, which, of course, offer tax incentives to the buyer. Again, the result is higher costs or lack of access to this capital.

As a result of the increased cost of debt and related capital, airlines are turning increasingly to equity, or what of late on Wall Street has been called "the E word," and as such the whole foreign equity ownership issue has come to a head, which we're in part discussing today. Let me assure you, relative to some of the previous conversation or discussion, that U.S. equity holders are willing—U.S. stockholders are willing to finance the U.S. airline industry if the returns are going to be adequate and if they're perceived as being adequate. American Airlines just last week raised $200 million to $300 million in a common stock offering that was brought below book value but nonetheless was "snapped up" by investors—small investors and large institutional investors.

So the U.S. market is still there, and in fact I would expect U.S. airlines will increasingly turn to their shareholders, current and new, to finance in part the growth and the capital spending that I noted earlier. However, equity financings can be expensive as well insofar as the dilution they would represent to current holders. Again, AMR sold their stock below book value.

Now, regarding foreign investment, I thought I'd just try to answer a couple questions on that that were addressed earlier. What are foreign investors after in the U.S. marketplace? I think they're after a couple things. First and foremost, they are after a return on their investment. Everybody is. But, sure, they're after other things as well. Perhaps back door cabotage, whatever. I see it as they're also after increased access to airports. Witness the SAS transaction. They were having problems at Kennedy, they do a deal with Continental, and they've got nice access at Newark. Some airlines are after feed traffic. KLM-Northwest. Clearly, that investment was aimed at somehow developing a relationship that would include feed. America West and Ansett of Australia are after different things. They have an aircraft swap program where airplanes go back and forth between the two countries.

There is capital in the U.S., and U.S. investors are willing to step up to the equity needs of U.S. airlines; however, it's a mosaic. It's not necessarily black and white. I think the airlines are looking for the U.S. and the foreign investor. For the foreign investor, the experience has been absolutely awful. Ansett bought their stock in excess of $10 in America West; the stock is at $6. SAS bought their stock in Continental at $14; the stock is at $2. I'm not advising them to average down at this point. KLM and Northwest—KLM was actually looking, oddly enough, to get their money back, I think, but the Secretary's ruling has in fact secured their investment, much to the happiness of Northwest, but I think KLM would rather have had the capital back because they're having capital problems in their own country. It looks like the only transaction that has really worked has been Delta, Swiss Air, and Singapore Airlines. Each of them own 5 percent of each other, and that appears to be working quite well.

Now, given this record, why would any foreign investor step up to the plate without the ability to control their investment in some way? So here we come to the last aspect which I'll offer the committee in this summary, and that is on the policy issue. To answer the question I just posed, Secretary Skinner's move last week does little to incentivize foreign investors who are looking at this track record to do anything else. As Helane mentioned, the 25 percent voting interest has stayed. The law, in fact, has just been interpreted, as I understand it, not necessarily changed.

I would concur with the thought put forth by GAO and others—I guess really by others—that if control is granted to a foreign entity to control a U.S. airline that we should have the same right in return. But clearly, without control, there isn't going to be any equity capital from foreign sources that I can see coming forth.

Secondly, I think—and I was encouraged by Representative Mineta's comments earlier—I would strongly encourage looking at investment tax credits once again, as distasteful as that might be in these, you know, very budget-conscious times. The fact of the matter is that ITCs or some form of them did promote significant investment in the airline industry.

Lastly, in my formal prepared remarks I noted what I perceive to be some abuses of the bankruptcy code and perhaps some interpretations of the bankruptcy code, and I'm not talking about companies abusing the bankruptcy code. I'm referring to courts abusing the bankruptcy code. In the case of Braniff, where the court ruled against section 1110 provision of the code and disallowed investors their rights to reattach or recapture assets, as is contained in the code, and in the case of Eastern, which is a tragedy and a travesty in many cases in many respects, but certainly the creditors, I think—not to mention the employees—insofar as that bankruptcy was run in "the public interest," which I don't believe is contained in the code, that bankruptcy being run in the public interest was to the detriment of the creditors, of course, most of whom have been wiped out.

I think we've got to look at the bankruptcy code as we did a couple of years ago after the Lorenzo abuse and perhaps see if we can't strengthen it in the favor of creditors, because creditors are scared. They don't know what they have. They don't know whether they have secured paper, unsecured paper, and, of course, it's rather pertinent right now with respect to Continental and Pan Am.

Again, I thank you for the time you've allotted me, and I would be happy to answer any questions you have.

Mr. OBERSTAR. Thank you very much, Mr. Pettee. We appreciate your insights on these issues and some interesting perspectives that you've offered here. We'll come back to you with some questions.

Mr. Baggaley, welcome again to the committee. You've been here before.

Mr. BAGGALEY. Thank you very much, Mr. Chairman. It's good to be here again. Thank you for the opportunity.

About a year and a half ago, I was talking about leveraged buyouts. It seems every time I come here something dismal is happening to the industry.

Mr. OBERSTAR. Yes, but you've come in the nature of a fireman to put out the fire and to offer hope and solution, not to hang crepe around it.

Mr. BAGGALEY. You've presented me with a tall order there. I'll see what I can do to satisfy that.

The present crisis is probably the worst ever suffered by the industry, and considering what they went through in the early 1980s, that's really saying something. The immediate causes of the problem are, of course, recession, high fuel prices, and more. You've heard this many times, so I won't belabor the point. Rather, what I'd like to do is explain why the industry is so vulnerable to these events and what this implies for the future.

As to fuel, it accounts for 15 to 20 percent of an airline's operating costs. Unfortunately, there is very little that can be done in the short run to counteract an increase in price. Over the long run, buying new, more fuel efficient aircraft helps. However, the total cost of ownership and operating these planes is more expensive than those of the ones they're replacing, and that's a very important thing to keep in mind as we look at the capital needs of the industry.

Airlines have responded by raising fares, but the added revenues generated fall far short of what is needed. Leisure passengers, who account for more than half of the total, are highly sensitive to price. Raise ticket prices, and they stop flying. Business travelers are more willing to pay the higher fares, but in the midst of a recession, even they are cutting back.

With fuel prices jumping and revenues lagging; some airlines have reduced service; however, this is not particularly efficient and suitable only as a last resort. Stop offering a particular flight, and you lose the remaining passengers still willing to fly. Furthermore, an airline route system is an integrated network. Cut in one place, and you hurt the rest of the system. Cutting costs while maintaining service is no easier.

Please take a look at the cost structure of Delta Airlines shown in the written copy of my remarks. This is for the calendar year 1990. You'll note that salaries are the largest item and the one most subject to direct control. However, pay cuts or layoffs undermine morale, service and reputation. Nevertheless, controlling labor costs is a necessity both now and over the long term. Unfortunately, some airlines face very difficult labor negotiations, and wide disagreement remains as to suitable levels of compensation, to say the least.

What does the current crisis imply for the future? First, we are likely to see further airline bankruptcies and further consolidation. Eastern is already auctioning off its assets. If the war and recession persist for even a few months, Pan Am's chances will be seriously undermined. TWA is already in default and under financial pressure as well. Continental is operating in Chapter 11. I still feel they have a good chance of reorganizing, but they are also certainly under a lot of pressure.

Now, it's important to recognize that the present crisis did not create the problems faced by Eastern, Pan Am and TWA. It only worsened them. These are, unfortunately, very weak airlines, and they have been for some time. In the case of the airlines with basically healthy operations but heavy debt loads, Chapter 11 can and probably will allow a successful reorganization. Therefore, I do not expect to see the industry consolidating into only three or four giant airlines.

A second important effect of the current crisis will be to erode further already weakened airline balance sheets, and you know things are bad when equity analysts like Helane Becker and Tim Pettee are talking about balance sheets and access to capital and creditors' rights and so forth. Those words did not exist in their vocabulary several years ago. The industry is highly leveraged and becoming more so.

I refer you to Exhibit 1 of my remarks, which shows debt as a percentage of capital for three strong airlines during a prosperous period in the industry, and you'll note that, first of all, the lines up top are all well above a broad index of industrial companies below, and they are also far above what you would suspect by simply looking at their balance sheet, and that's because there's a lot of off balance sheet leases which are nevertheless financial obligations, and they have to be met. When year-end 1990 data is available, of course, it's going to look even worse, because they all lost a bundle of money in that period.

The sad fact is that U.S. airlines cannot fund the expenditures needed to grow, improve fuel efficiency, and meet Federally mandated noise requirements unless they earn higher returns. The sale of common stock is difficult, although one airline, American, has done so recently. Easing restrictions on foreign ownership will help some. The amounts involved are not really that great, and as others have pointed out, foreign airlines will not put up money without the prospect of either adequate returns or some measure of control over the U.S. company.

Debt and leases, which provide the great majority of outside funding, are becoming more expensive. This reflects both concerns about airline credit worthiness and problems in the credit markets themselves. Unsecured debt is more expensive for strong carriers and has evaporated completely for weak ones. In fact, the outstanding unsecured speculative great debt has evaporated literally in the sense that it has largely defaulted.

Finance leases, the largest single source of funding, are also becoming costlier. Equity investors in leveraged leases have a reduced appetite for tax deductions. Japanese financial institutions are cutting back on overseas investment, and the value of aircraft, the collateral in secured debt, has weakened.

There is some good news amidst the gloom. Airline industry profits will recover by 1992 or 1993; the war will not last forever, hopefully not much longer at all; the economy will recover, albeit slowly; and fuel prices will decline, a process which has already begun. The large losses reported by Eastern and perhaps some others will no longer be included in the industry totals.

My concern is that this recovery will be misinterpreted. We need to consider two key factors when that time comes, and I know I'm looking ahead, but that time will come. First, keep in mind the industry's net profit margin. The average for manufacturing companies is 3 to 6 percent, depending on where you are in the business cycle. Airlines earned the cumulative average of less than 1 percent in the 1980s, with a peak of only 2.6 percent in 1988. Second, consider how much the industry is spending on new planes and facilities—a sum which will very likely be many times what they're earning.

A recovery in the airline profits will also raise the entirely legitimate question of whether consolidation has undermined competition. To begin with, profits are not the proper measure, airline yields are. If they can earn good profits by cutting costs, more power to them. Second, as I've noted earlier, airlines desperately need to earn better returns if they're to fund capital expenditures, so some rise in ticket prices is actually desirable. Given the operating leverage in this business, it wouldn't have to be much of a rise to improve their profits.

Even so, I don't think you'll see much of a large increase in overall yields. There are too many factors inherent in this business which will prevent that. First, there will be several major airlines with national route networks competing in all major markets. Second, discounts will be needed to attract vacation travelers who are price-sensitive. Lastly, the product offered, a seat on a particular flight, is perishable. It's more like bananas, say, than paper clips. Once the flight leaves, it's gone forever. Furthermore, the cost of serving that last passenger on board a particular flight is peanuts—sometimes literally peanuts. That creates a tremendous temptation to find some way to lure more passengers on board through low fares, frequent flyer miles, toaster ovens, or whatever.

Now, there is a competitive problem which worries me, but it's not the disappearance of several weak airlines. Consider the Northeast Corridor, the Washington to New England market. We have two air shuttles—one owned by a bankrupt airline, the other owned by a nearly bankrupt real estate developer— and yet ticket prices on those shuttles are over $100 for a very short hop flight. The major reasons are limited available slots and gates, terrible air traffic congestion, and high labor and other ground costs. In short, it's difficult and costly to operate there.

I put this question many times to Southwest Airlines, who is a very efficient point-to-point operator with low costs and good profits, and this is what they tell me. It's not worth the aggravation. They can't get in. It's too costly.

The real danger to competition, therefore, is inadequate infrastructure. Planes can be moved around, gates and runways cannot. Re-regulation will not solve this problem. Indeed, the half of the air transportation system which is still regulated—airports and air traffic control—is where the bottleneck lies. Likewise, the worst cases of uncompetitive pricing occur on international routes, where capacity is limited by bilateral treaties. Therefore, Standard & Poor's believes that the policies which will most effectively ensure healthy competition and healthy airlines are the following.

First, increase investment in infrastructure supporting air transportation. This is a matter of economic development and international competitiveness, not just convenience. Second, allow airlines to earn sufficient returns to support growth and modernization, and again, this is increasingly a matter of developing world class competitors in a global market. It is not inconsistent with proper anti-trust policies and promoting competition. The United States is a big market; it can support a number of vigorous competitors.

Third, develop a framework which allows good labor relations and reasonable labor costs, as some airlines have done already. This is not a utility which can pass on added costs to the consumer, but a service business facing fierce competition and costly investment. Finally, continue to push for greater liberalization in international air transport. This can include cabotage at some point in the future if the new opportunities granted are equivalent for both parties.

None of this is revolutionary, and most of it is probably not particularly controversial. However, stating it is one thing, and implementing it is another. That is the challenge. Thank you for your attention.

Mr. OBERSTAR. Thank you very much, Mr. Baggaley, again for very perceptive comments and insights on the industry.

I read with interest your proposal to Mr. Kelleher to invade the northeast. Another reason besides the ones which you've cited—which are right on target—that he would not make that invasion is that he also has a protected market. He won't even move to Dallas-Ft. Worth Airport, let alone move to the northeast. The Love Field protection ensures nobody will invade his airport and guarantees that he'll never move out of that protected little cocoon over into the big time next door, where indeed he has been offered immediate availability of gates to serve whatever markets he chooses.

He's a very smart operator and a very likable operator. A very delightful fellow. But it is not the "mom and pop" airline operation that some people think it is. It's a billion dollar carrier that serves 140 cities and several foreign countries, and he knows what he's doing.

I would like to address from another standpoint the matter of capital investment. The thrust of your collective testimony is that the principal need of the airline industry for investment capital is for new aircraft, but their big problem is cash flow.

Mr. BAGGALEY. Quite so.

Mr. OBERSTAR. Most of which problem for certain carriers, some of which you've identified and others which we need not be specific about, was brought on by their own decisions. Nobody forced—no Government regulation forced — any of those carriers to acquire another carrier or outside investors who were not in the airline industry previously to accumulate massive amounts of debt to buy a carrier. They weren't forced, there was no gun at their head, no government regulation said "You have to get in the airline business." They did it on their own. Now that they've got all these problems that were created by the economic downturn, by the Persian Gulf situation, they're saying, they need help, they need capital assistance.

But massive amounts of capital investment, except for acquisition of new aircraft, it seems to me is no response to their short term problem. So why should we open the flood gates of foreign investment if, as you have indicated, other analysts have indicated, and the airlines themselves said in their testimony yesterday, "There's a poor return on investment on this industry. There always has been a poor return on investment, so we can't get the capital, so we need money."

Well, foreign capital is not stupid. It wants a return on investment but can't get a return on investment. So foreign investors must be looking for something else, and I think Mr. Pettee said it well—control. They're looking for control. What other benefits could there be from an influx of capital? Have I missed something?

Mr. PETTEE. From foreign capital?

Mr. OBERSTAR. Well, from any source. I mean, I don't think we ought to just drop this one element of our Federal law on ownership all by itself, because it has to be seen in the context of broader international issues. There are many other questions that have to be addressed along with the ownership issue. Reciprocity is one of them, the degree of ownership and along with it the question of cabotage at home and abroad. I think it's a mistake to just reach out and say, "Here's the solution to the problem." We need a better definition of the problem, it seems to me. What issues can more capital address or resolve for the airline industry regardless of source?

Mr. PETTEE. Well, I'll take a stab at it. What benefits are to be derived from more capital I think is what you're asking. Stepping back a second, the industry in the 1980s, as I mentioned, was fantastically competitive with all the capital coming in, and there were some excesses. There was clearly too much capacity, and there is a degree of too much capacity in the industry today. The fact that Eastern has gone out and you haven't heard a great deal, I wouldn't guess, of complaint or I don't think DOT has probably had a sharp rise in consumer complaints, the air traffic system has responded quite well to this, you know, abrupt end to what was once one of the biggest carriers.

During this period, the U.S. industry actually lagged the rest of the world in terms of fleet upgrade. Our fleet is measurably older than the average in AEA. The U.S. fleet is 12 years old, AEA is something like 10, and, of course, in the Far East the average age is high single-digit. This period has seen, you know, our infrastructure lag, the airport question, airport access, et cetera.

What benefit additional capital could bring to the industry is along those lines. It's basically upgrading this industry. Necessary property, plant and equipment upgrades have to be made, because we have great expectations out of this industry. Witness CRAF. Witness the fact that so many Americans are traveling today relative to 12 years ago. You know, deregulation was not necessarily an experiment. It was more than an experiment. So I think what could be derived is a necessary upgrade of this industry, which has lagged during the 1980s to some degree.

Mr. **Oberstar**. Ms. Becker?

Ms. **Becker**. The issue is not access to capital for every airline company. It is money for airline companies that are financially strong, having demonstrated an ability to manage the existing assets will always be available. As Tim Pettee illustrated earlier, the AMR Corp's 5.7 million share offering, done a week and a half ago, was oversubscribed, both here and in Europe. United, Delta and other financially strong airlines that may want to sell equity would probably find their issues equally well accepted.

On the other hand, companies that haven't been managing their assets or, that haven't earned a decent rate of return for their current shareholders, are likely to find the capital markets closed. These will spend 10 percent–12 percent, for debt financing. These are won't be able to sell equity. This business is how well an airline company can manage the assets it has, and is there truly a need for more assets.

As Tim said, there has been an issue of overcapacity in this industry for years that's been exacerbated in the last month or two. It will continue to be a problem in the next month or two because of factors beyond the control of airline company managements. In instances, where jet fuel is 40 cents a gallon, it's cheap to operate a three-engine plane. In an instance where jet fuel is $1.10 or more a gallon it doesn't make sense to operate the same plane. It will be retired, and by definition the average age of the fleet starts to come down.

Mr. **Oberstar**. Mr. Baggaley, do you have any comments?

Mr. **Baggaley**. Yes, just very briefly. Mr. Chairman, I certainly concur with your thought that the airlines are given their chance and they can live or die by it. I think my concern looking forward into the future more is that when the stronger airlines do earn improved returns and they earn the money they need to shore up their balance sheets, there will be a concern that those profits are excessive, and if they have to re-equip and meet Federal noise standards and so forth, which I think is a worthy objective, they do need to earn good money. And it's a process that builds on itself. If you're earning good returns, creditors extend you credit at lower prices, and new shareholders are willing to buy new stock. Unfortunately, the process goes the other way, too.

Mr. **Oberstar**. Well, I think Ms. Becker, at the outset, said, "We believe in a marketplace solution." If all three of you believe very strongly in the marketplace, that's your business, and the Congress concurred in 1978, when in this very committee room the deregulation bill was passed to return the economics—or I should say to put the economics—of the airline industry into a marketplace setting free of Government control of rates, entry, and routes domestically, and we're trying to find a way to help that market work. But there still are elements of Government regulation that are necessary because of the public interest, but they have a market impact. Notably, the slot-controlled airports.

It seems from testimony we've heard previously in hearings that some adjustment in the four slot-controlled airports is necessary for the whole industry. The way in which those Eastern slots are disposed of will have a very significant impact on the rest of this industry, probably far more significant than if additional capital were available to carriers who, by the results of the bankruptcy proceeding, would not be able to serve this market or this Washington area market or the other markets that Eastern operated. So how that matter is resolved has significant marketplace impact, but it's a Government regulatory decision to some extent, and dealing with some of these impediments and barriers is a real challenge for the Department of Transportation, for the FAA, and in this instance of Eastern for the bankruptcy court.

I'll come back in a moment with some other observations, and at this point I recognize Mr. Hobson.

Mr. **Hobson**. Thank you, Mr. Chairman. I share your concern about the management of assets and would like to ask a few questions about that if I may, because in the last couple days that I've been sitting in here, I hear foreign investment is the answer.

I'm a little concerned if you say that 1 percent is a good return in this industry. I don't think it is if I were an investor.

Mr. **Baggaley**. Nor do I.

Mr. **Hobson**. And what do foreign investors do differently as a return on—the first question I have is why would a foreign person invest in an airline for 1 percent or 1.5 percent if that's good—I assume that United and American are better than that—or are their investment objectives different than domestic capital?

Does anybody want to take a shot at it?

Mr. **Pettee**. Well, I'll take a shot at it. I think that the number one objective that a foreign airline entity would have in a U.S. airline is some return on investment. Yes, the profit margins are low in the airline industry. Return on equity investment is not always that low. Airline stocks tend to exhibit significant swings both ways, but clearly the investments that have been made have been with things other than return on investment in mind. They are looking at other issues, and specifically looking at the cases, as I noted, KLM had been somewhat blunted in the bilateral process and in participating with Northwest was looking to capture in some way some of that feed traffic that Northwest could bring perhaps to the KLM system, either at Amsterdam or, ideally for KLM, at Minneapolis and Detroit.

And again, Ansett and America West. Ansett invested I think $100 million, a significant sum, for a different reason. They were looking to engage in aircraft transactions. You know, when it's peak season in Australia, it's light season in Phoenix, so aircraft go back and forth on a 6-month basis. They have a pretty strong relationship in that respect.

SAS—return on investment, yes. Maybe they wanted control from the beginning, and they've got a significant element of control now with Lorenzo not there.

Mr. **Hobson**. I think that's what worries a lot of us about that.

Mr. **Pettee**. But they were very concerned about airport access at JFK. They felt they had a lousy operation at JFK, they wanted to be over in Newark; what better way to be in Newark than to hook up with Continental? Unfortunately, their investment is down 98 percent.

Mr. **Hobson**. I just wanted to hear somebody say that, Mr. Chairman, because we hear different things on the capital. But what's going to make the weaker airline—let's suppose you get the capital. Why do you think that this management team, which investment bankers over the years have said are great because they—a lot of this is a result of investment banking. The people that came in and bought the junk bonds and said they're going to go to market, got a lot of advice—I don't know if rating agencies, but I'm sure banking industries or the investment bankers gave advice.

Why will this influx of foreign capital cause a better management of those assets in the weaker operations? They made some bad decisions. Why are they going to make them right now?

Mr. **Pettee**. Well, personally I would not agree with the notion that the foreign capital is only aimed at the weaker airlines. The fact of the matter is American and United don't want to sell. They don't need Ansett. They don't need, as United has demonstrated, British Airways. So again, I want to go back and say that I don't think it's being presented as this is the only answer. You know, let's bring British Airways and let's get a few billion pounds in here to solve our problems. I think it's being viewed by the airline industry and by the investment community as part of a solution to an industry that doesn't have enough capital, but I don't think it's just going toward the weaker carriers. It's the weaker carriers that are most susceptible or that need it the most, and in a couple cases there have been some deals as a result.

Mr. **Hobson**. But what makes you think—and maybe it's to Ms. Becker, because she was talking about the management before—what would make you think if we give $100 million to a management team that's already in trouble, and we're not going to let them have as much control probably to operate it, that that team is going to be able to turn it around and make it operate better?

Ms. **Becker**. I don't think they could. I think if they demonstrated an inability to manage with existing money, including that of existing shareholders, I don't see why it could be done with foreign investment. I also don't see why anybody would think that. I don't think that's the motivation from the foreign side. From the U.S. side it may be another source of capital and it may be another market to tap into, but from the foreign side I think it boils down to one thing, and that's a way to go around the bilateral process to get increased access to the U.S. market, period. I don't think there's anything sinister beyond that. We're dealing with airline companies that have very small home markets, looking at Europe 1992 or so, saying "How do we compete with a marketplace that's 280 million people versus 17 million."

To answer your question more directly, I don't think there's any way a poorly managed airline company in the United States is going to be rescued by foreign capital. I don't think that that's what the foreign airline investor wants. All investors want a rate of return on investment that can be comparable to that of other industries: If you're going to put money into something, you want to be able to take your money and more out of it.

Mr. HOBSON. Can I switch subjects for just one second?

Mr. OBERSTAR. The floor is yours.

Mr. HOBSON. The other subject I'd like to talk about is in the asset management side of this, if you get a team that can function. One thing that seems to be reoccurring in this, and we can talk about fuel prices but those seem to be fluctuating and are a problem that you can't always anticipate, but something that always seems to be alluded to and then when we get into it, it runs away, is the labor costs that run through the industry, and when they run through, they seem to run through in all different places.

Yesterday I heard that many of those who have gone into financial difficulty had low costs—correct me if I'm wrong—had low cost operations, and some of those that have the higher costs are doing better. Yet you hear other people say it's the cost of the employee. Is that where the problem is, or is it in the debt structure? Where is the basic root cause of these management structures that fail?

Mr. BAGGALEY. Mr. Congressman, may I take a stab at that?

Mr. HOBSON. Sure.

Mr. BAGGALEY. First of all, I would say that the quality of airline management in general has improved considerably since I've been following this industry, which is a little over five years, and sometimes the captains going down with the ship are not the people who ran it into the iceberg.

As to the matter of labor costs, these do vary widely, and you're not going to see any correlation directly between success and failure, because some of the troubled carriers that formerly had fairly high labor costs have asked for concessions and gotten them, and now they're still in trouble. That helped them, but it didn't help enough.

I think you do see some airlines such as Southwest and America West which have been fairly successful. They have lower labor costs, but importantly, they have good productivity, too. If I were to recommend something in labor negotiations in general, it would be that work rule productivity and profit-sharing are fruitful areas for exploration and hopefully a little bit less controversial than flat-out pay scales.

But it is true that some of the stronger carriers have relatively high labor costs, and that is dragging their balance sheets down along with a lot of other things, not exclusively by any means, but that does compromise their ability to re-equip and grow, and I would certainly not put it all on that by any means. It's just one more factor, but it's something that has to be kept in mind in negotiations and in looking at the industry.

Mr. **Hobson**. Thank you, Mr. Chairman.

Mr. **Oberstar**. To pick up on that point of the labor factor, Secretary Skinner devoted a page and a half of his testimony and a good deal of his time to a critique of the labor/management relations, yet it occurs to me that even if wages in the industry were one-third lower than they are today, you'd still have the national recession, you'd still have the higher fuel prices, you'd still have the high cost of leveraged buyouts facing the industry, and I don't think they'd be significantly better off or any better off at all.

Mr. **Baggaley**. Well, in addressing Mr. Hobson's question, the common denominator in the Braniffs and Easterns and Pan Ams—and they all cried foul on the way down with respect to labor costs and whatnot or fuel costs—the common denominator is that these companies failed to respond to changes in the marketplace. Some of them——

Mr. **Oberstar**. That, I think, is the key. If we are looking for the common denominator in response to the question the gentleman asked, that's it.

Mr. **Pettee**. Well, some of these changes in the marketplace nobody could have responded to. I mean, not to get too far afield, but one of the reasons Pan Am is having so many problems is that you need not go to New York to connect to go to Europe now. There are 29 gateways in the United States to get to, I think, 32 cities in Europe. Ten years ago there were six, and, of course, most everybody flowed through New York. Now there's 29. I don't know if there's any management in the world, quite frankly, that could have generated the ideas, the capital, the employee motivation, et cetera, to address that what I would call structural problem.

So yes, on the way down, they're going to say strategic reserves, high labor costs, you know, we're being ripped off on debt or whatever, but the fact of the matter is this is a constantly evolving marketplace. The reason American Airlines sold out their equity offering last week is that their management is perceived to be better than anybody else, and even though the stock was below book value, that management has responded, perhaps overly aggressively, you could say, but they have responded to the changes in the marketplace. They've set up hubs everywhere, and they're in Europe, and they'd just as soon have a hub in Tokyo and Brussels and everywhere on earth, but the fact of the matter is that they're responding to the changes in the marketplace, and they're not going to fail as a result.

There are a few carriers that aren't responding that can't because they don't have the money to do it or they don't have the management to do it, and I read with interest Mr. Skinner's comments with respect to labor costs and the Railway Labor Act, and I've heard parallels drawn between the airline industry and the auto industry where several years ago the relationship between the compensation of the average worker relative to the compensation of the average consumer got out of line in the auto industry, and some have suggested this was the reason that the auto industry in the U.S. got into such trouble.

I don't know about that, but the common denominator is not high labor costs. I mean, you know, look at Mr. Kelleher's airlines. He pays his people quite well. They're very, very productive. I think productivity is the key on the labor issue, the ability to cross-utilize people and, to recite what they say, "to get eight hours of work for a day's pay." But it's the changes in the marketplace, I think, that has resulted in the failures at a number of carriers.

Mr. OBERSTAR. I think that's a very careful and very astute analysis, and in the case of Pan Am, they were the beneficiary for years of a regulated environment, and when deregulation came along they were not positioned well to benefit their international routes, because they didn't have a well developed domestic network. Those who did were able to better take advantage of international service opportunities, because they had the network at home to nurture an international service.

Ms. Becker, on page 4 is your observation, at the bottom of the page, speaking to "the Northwest-KLM agreement is future service opportunities. If Northwest expands in a market KLM serves, will KLM object?" Well, I think just the reverse happened. KLM expanded into a Northwest market, into their back yard, in a service that Northwest had declined to make for many years—Minneapolis-St. Paul-Amsterdam. The Twin Cities Airport wanted Northwest to serve that market, and Northwest declined for many years prior to the takeover. Amsterdam Airport and KLM wanted that service because they felt it would give KLM great opportunities to serve the heartland of the United States from the Netherlands.

It was, it seems to me, just a little more than coincidental that only after KLM made the investment in Northwest that the resistance to that service disappeared, and the Department has now approved a city pair between Minneapolis-St. Paul and Amsterdam, in which no previous service was offered and in which there presumably would be great public benefits. I think it's because one partner silenced the other or persuaded the other that there was an opportunity for one of them to benefit. Both of us can't benefit, so one of us will. That one was KLM.

Mr. PETTEE. I think that's part of KLM's return on investment objectives.

Mr. OBERSTAR. That's the way I interpreted that.

Mr. PETTEE. It's difficult to put a number on that. Again, I think, you know, their number one objective would be at some point to have an exit strategy, you know, to be able to sell that stake, but clearly at this point, given the results of the industry, it's probably the highest weighting that they would give on that return on investment.

Mr. OBERSTAR. And after thinking it over and talking to all those who might be involved in that service in my State, I supported the route authority approval. It made good sense. But again, KLM did not simply buy with their $400 million equity investment in Northwest a ticket to the game. They bought a seat on the bench right next to the coach. [Laughter.]

That's what has me worried for this whole industry for the future.

Mr. Pettee, you talked about the need of creditors and investors for greater protection from abuses and inconsistencies in bankruptcy courts and left a tantalizing tale hanging. Elaborate on the inconsistencies and abuses and how they might be addressed. We're at a very important juncture. I think that two departments of Government are very much in need of advice.

Mr. PETTEE. I didn't mean to leave the issue hanging. To elaborate, specifically with respect to the Braniff bankruptcy and then the Eastern bankruptcy, with respect to the Braniff bankruptcy—and I'm talking about Braniff II in 1989—I'm not a lawyer, but I'm sufficiently in bankruptcy—there is a provision in the bankruptcy code known as section 1110, which, as I understand it, if a lender has an obligation that meets the section 1110 test or standard, he or she can reclaim or recapture, seize, whatever you want to use, that asset if the company, Braniff, does not reaffirm its intent to use that asset and pay for it within 60 days.

Just last week, Continental made a $100 million payment to it's "section 1110 lenders," although not all of the people who thought they had section 11 protection got their payments, and they're still prohibited from getting their assets back. In the case of Braniff, as I understand it, the bankruptcy judge at a Central Florida court refused to honor section 1110, believing that it was in the best interest of the estate to not let these entities—it happened to be that these entities that wanted their assets back were foreign entities—GPA, a big leasing company, and Airbus, a manufacturer—refused to honor section 1110. Eventually, Braniff liquidated, eventually GPA and Airbus got their planes back in effect, but not without considerable expense and considerable pain and sweat as to what in fact are the bankruptcy laws in the United States.

Secondly, with respect to Eastern—again, total tragedy in terms of employees in the operation and the assets—the Eastern bankruptcy was run with a public interest theme in mind by the bankruptcy court in the Southern District of New York. Again, I'm not aware in the bankruptcy code that there is a provision that the public interest—I think there are other forums for the public interest—that the public interest, i.e. the travelers, the folks holding the $114 or $289 tickets, be the primary beneficiary of the organization process. Chapter 11 is there for the estate to manage its affairs, etc.

What happened was, with the public interest being the motivating factor in that bankruptcy, the cash from asset sales from operations was simply expended right down to the last dollar until I think they could not essentially operate, and as a result all the unsecured creditors, it's my understanding, were wiped out, and the secured creditors, as we're finding out in the auction process that's happening now, are not going to get dollar for dollar.

The bottom line is that it has significantly undermined, in my opinion—and Phil and I were talking about this earlier—it has significantly undermined the confidence that financial institutions, aircraft lessors, and others have in the industry. I spoke to a Pan Am creditor not too long ago, and he didn't know whether he had 1110 protection. He showed me a document that said, you know, it is, but he was obviously concerned that he was not going to get paid, he was not going to get his plane back or whatever he had.

So the bankruptcy code was looked at in 1987 or 1988, after the Continental abrogation issue and contract problems, and the bankruptcy code was significantly upgraded to address abrogation of labor contracts. In fact, I think it's similar to section 1110. You can't do it unless 60 days' approval from the court. There is some detail in the prepared testimony regarding this, and I noted what I think is a growing trend that is undermining the confidence of people, banks, lessors, people that make their living off the airline industry finance market, that they're just not going to be there anymore.

Mr. **Baggaley**. Mr. Chairman, may I add a brief comment on that?

Mr. **Oberstar**. Yes, certainly.

Mr. **Baggaley**. We're very interested in this process, of course, and we are seeing a lot of it these days at Standard & Poor, but each of these cases are ones where the code is fairly cryptic—and 1110 is a short section, you can read it in about 30 seconds—and it leaves a lot of things open, and there are gray areas, and the broader point I would make is that when gray areas here or in other parts of the code are interpreted in such a way as to favor the debtor or some other party, that's okay, but that also puts a chill on future financing into the industry, and you're sort of taking with one hand from the other, and some innocent bystanders, other airlines, could get hurt. Pan Am's reorganization, I think, is made more difficult by the Eastern precedent, for example.

Mr. **Oberstar**. Thank you.

Ms. Becker, you dwelled at some length on the reality that the airline industry is pricing its product below cost on a rather consistent basis, and you don't see much change in that. We do see a lot of these discounted fares; in fact, they tooted their horn yesterday about how many fares were discounted. The reverse side of the coin is that—the question is is it being done because there is real competition on city pairs, or is it being done in absence of competition and in the hope of the airline of attracting business, and if so, then what good is that business if the discounted fares don't meet your costs? Is the other side of the coin that there is no hope for profitability for the industry if this practice continues?

Ms. **Becker**. To answer the last part of your question, I hope not. I spend a lot of my time making the argument that a secular change took place in the industry over the last few years that would allow for a better pricing environment. There are a couple of things that will make the point. First, I think there is true competition in city pairs. There are some markets that you might consider monopoly markets. For example, the Houston to Washington example, where there is one non-stop way of travelling. There are, however, numerous other ways of getting from Houston to Washington, DC, The traveller must be willing to make a connection somewhere between the two cities. That option exists.

The fact is over the last 10 years the business traveler subsidized the pleasure traveler. At some point, the U.S. consumer became used to the idea of low fares. If you go back and look, from 1950 through now, adjusting for inflation, actual fares have declined almost in every year. Airline industry yield has never been priced in such a way as to ensure an adequate rate of return. Obviously, part of that period the industry was regulated, and part was deregulated.

Part of the solution to the pricing problem is retraining the public to pay for the service. If a traveller wants to get from one city to another the fare should be commensurate with what it costs an airline to provide the service. The problem is, that the airline industry is a young industry. The industry as we know it is 12 years old, because that's the period during which its been deregulated. When it was deregulated, there was no pricing policy that the industry had. There were few industry executive that knew how to price profitably, because they had always had their prices set. I think the industry has been evolving.

As I said at the outset, I hope it continues to evolve in such a way as to ensure an adequate rate of return. The bottom line is that discount fares will always exist, because that is one way to stimulate the market.

Mr. OBERSTAR. Well, the real question is are those discounts going to continue and is that kind of competition going to continue if you have only four, five or six carriers? Will there be enough competition in the industry, from your analytical standpoint, to sustain competition and the benefits to the public?

Mr. BAGGALEY. As I believe some of the other witnesses have said, the proper base of comparison is not how many carriers but how many carriers in a particular segment or city pair. You could have no competition with lots of carriers if they each carved out their own little fiefdom. As Helane said, I think first of all you're going to see some discounts for leisure travelers just to stimulate traffic. They won't be as deep as they are now, and probably they shouldn't be, because otherwise the airlines can't earn any money.

The main obstacle is going to be free entry. We already have that problem in the northeast. If there is adequate infrastructure, I think you will have enough competition. If we don't build more airports and air traffic control, you're going to have loss of competition, whether there are a few or many carriers and whether it's regulated or not regulated.

Mr. OBERSTAR. Well, on the airport and the air traffic control side, we are committed, as a result of legislation last year, to a $50 billion investment program in modernizing airports and runway capacity and a $25 billion modernization program for air traffic control through the rest of this decade.

I had one other point I wanted to raise, but we're on the down side of the second bells on a recorded vote on the House floor. If you will bear with us for a few minutes, we'll return in about 15 minutes.

[Recess.]

Mr. OBERSTAR. The subcommittee will resume.

I wanted to explore a little further with the panel, particularly Ms. Becker because you addressed this issue both directly and indirectly, and by the way, may I say I love your cross-ownership chart on page 4. I posed in a sense a conundrum for the Secretary listing the cross-ownerships that exist in the industry today as a way of underscoring the globalization that is occurring in the airline industry, and while it is indeed intriguing, it also raises some serious policy questions for us.

But the question I want to have you explore further is that of the computer reservation system. You're suggesting market solutions, yet can the public stand by and allow monopoly to take place that in itself can be anti-competitive? The Justice Department almost two years ago decided that it would be anti-competitive to allow the merger of the CRS systems of American and Delta. They later found that it would not be anti-competitive for Delta and Northwest to join, and I concur on that conclusion.

But should there be more actions taken in the CRS area as suggested by the GAO testimony, which recommended elimination of booking fees, elimination of minimum use fees, elimination of the five-year term for contracts for travel agents? Should there be establishment, to be totally neutral, of a common CRS? Those are just a few things I'm sure you have your own ideas on, but I'd like you to respond to that and then perhaps Mr. Pettee as well.

Ms. BECKER. Okay. Thank you, Mr. Chairman. I'll try to.

First, I'd just like to say all the credit for these beautiful charts goes to my assistant.

The issue of computer reservation systems is an interesting one. Going back to the mid-1970s and the early 1980s, the airlines that have the most successful computer systems were the ones that initially decided it might be interesting to begin to develop the systems. Technology was just beginning. The software, computers, and so on, that would enable the complex travel schedules that travelers need was just beginning to be developed. A lot of industries began to use computers to make their business easier.

The airline industry was no exception, I find the development of these systems quite interesting. Because a few airline companies came late to the party, they complained the loudest about booking fees and agency installations. I don't think there's anything wrong with a company coming up with an idea, making it work, and earning a decent rate of return on it. I don't think there's anything wrong with American Airlines developing the Sabre system and having their flights listed first.

I realize it's illegal now because of the bias inherent in the original system. I never thought it should be an issue. American took the risk, invested the capital, hired the people to develop the system: it deserves the reward. It's no secret that American employs 93,000 versus United's 80,000 with two airline systems that fly about the same number of available seat miles annually. The difference is on the technology side, because American believes in investing in the technology needed to be competitive in a worldwide marketplace.

I didn't think there was anything inherently wrong with Sabre and Datas II merging. Datas II was a completely non-competitive computer system. It didn't have nearly the travel agency exposure it deserved. Delta Airlines as an airline controls 14 percent of the industry's share. Datas II as a computer system, before the merger with Pars, controlled 7 percent. There was some inequity in that.

Furthermore, I don't think it's bad to have booking fees. If an airline is willing to take the risk and spend the money, they deserve a decent return on their investment. So I don't think there is a monopoly in these systems as well. There is SystemOne, Sabre, Worldspan, and Covia in the United States; Amadeus, Galileo, Gemini, and others internationally as I have indicated on page 6 of my prepared statement.

The airline industry is a commodity industry. So are the computer systems. Phil mentioned earlier, it's a perishable commodity. Every time a plane takes off with an empty seat, it can never be sold again. To the extent the computer systems can be used to maximize revenue on board the aircraft in any way possible, whether it's through a mix of cargo and passengers or through a mix of high fare and low fare paying passengers, it should be done. I think that's what these systems are doing. I don't think it's bad.

Mr. OBERSTAR. Yes, you get the Adam Smith award, the Demming award, and AT&T probably wished you were Judge Green.

Ms. BECKER. I'm sure of that.

Mr. OBERSTAR. Well, I think there is an argument to be made, as you've made it very eloquently, very, very well. However, when those systems result in a pipeline flow of revenues from other carriers into that one carrier, you know, I know that Mr. Crandall has often said that if he had a choice between keeping the airline or keeping the CRS, he'd sell the airline.

Ms. BECKER. That's true.

Mr. OBERSTAR. Because the CRS is much more profitable. But it does create, from the public standpoint, a very dangerous monopolistic condition, and I think that, again, creative genius that leads to monopoly is not within our system that encourages competition.

Ms. BECKER. But, Mr. Chairman, if I may, I don't think it would. I recognize that the pre-tax margins on the computer systems of Sabre and Covia are 18 percent, but they're coming down. In 1986, these margins were 41 percent; in 1989 it was 24 percent, and in 1990 we estimate that the pre-tax margin was 18 percent. Competition or an open marketplace argues that high pre-tax margins won't last for long periods of time, because if the margins are that attractive others, will come into the business as competitors.

For example, EDS found SystemOne extremely attractive last year. Recognizing that we're talking about billions of dollars to develop these systems, it does not have to come from airlines. If the returns are great, other companies like AT&T, American Express, and other travel-related companies may find the investment worthwhile to try to develop a competing system.

Mr. OBERSTAR. However, the reality of the market is that it is highly unlikely that any outside competitor can come into, say, Dallas-Ft. Worth and challenge Sabre, when they have all the travel agents lined up and they have them on multiple-year contracts, they have minimum use fees, they are stuck with booking fee requirements, and there is just no way that anyone can compete against that. The liquidation fee to cancel your contract runs as high as $65,000 for a travel agent.

It's prohibitive, once you've signed on with any one of these systems, to get out of it and move to something else. It's unrealistic. The theory is that you can come in and have competition, but the reality is that the practices put in place make competition impossible. Ask a travel agent. They'll tell you that.

Ms. BECKER. And it's true. In fact, we'll tell you that, too. But in some agencies, two systems are used. Sabre would do back office ticket management, and Covia actually does reservations. In some instances there is a competitive nature within one travel agency.

I don't believe there are monopoly practices in this industry across the board. The margins are attractive enough that it argues for more competition.

Mr. **Oberstar**. Thank you very much.

Mr. **Pettee**. Mr. Chairman, could I just add to that?

Mr. **Oberstar**. Certainly.

Mr. **Pettee**. Relative to your question earlier about—actually, I guess it was Mr. Mineta's question—about commission overrides, when the CRS systems were policed to eliminate the biases, et cetera, and were made neutral to some extent, this is when the commission override issue became prevalent, because what the airlines—you know, as you look into this issue, they're entirely related. As the airline industry had supposedly a neutral system, they went out to the travel agents and said, "Okay, now you've got a neutral system, but if you give me that $85,000 worth of business, I'll give you a 13 percent commission on it." That's how they lock up.

So if you go back and equate the commission schedules and regulate the industry at 10 percent for everything, obviously it's going to put some pressure on the airlines to respond in terms of making their reservation systems more competitive maybe. There are going to bias issues and that kind of thing, and I just wanted to point out for the benefit of the committee that the commission override issue came up really in force, at least domestically, after the CRS policing, and I would just—I think you both articulated it very well—I would just offer that it probably continues to need to be policed to some degree.

Mr. Crandall—one of his favorite topics in addressing us on Wall Street is the reservation system. He likes to say, "If there's going to be a neutral system, and if the Government wants it, they can have it, and here's my price." As a shareholder of airlines, I would have to concur with his thinking insofar as, you know, he's looking for some return. But perhaps the middle ground is that it continues to need to be policed, particularly if we start fooling around with commission overrides, because they'll respond in some way.

Mr. **Oberstar**. Well, those are very thoughtful comments and I think perhaps a good point at which to conclude the hearing. You've offered us some good insights into the financial condition of the industry, the market, where it is, where it's likely to go, what may be the consequences of various Government decisions, and how the market might best adjust in the future. You've been most productive and helpful, and we appreciate the time and effort you've devoted to developing your testimony and being with us this afternoon.

Mr. **Pettee**. Thank you.

Ms. **Becker**. Thank you.

Mr. **Baggaley**. Thank you, Mr. Chairman.

[Ms. Becker's prepared statement appears on p. 484.]

[Mr. Pettee's prepared statement appears on p. 584.]

[Mr. Baggaley's prepared statement appears on p. 479.]

Mr. Oberstar. We will now relocate the hearing to room 2253, since the votes this afternoon delayed us beyond the time allotted for this hearing. There's another event that must take place in this room, so we will relocate just upstairs of this room at 4:05.

[Recess.]

Mr. OBERSTAR. We will resume the hearing of the Subcommittee on Aviation with our next panel, testimony from the flight attendants. Cheryle Leon, President, Association of Professional Fligl Attendants; Mr. David Borer, Director of Collective Bargaining, Association of Flight Attendants; Brian Moreau, President, Independent Union of Flight Attendants; and Victoria Frankovich, President, Independent Federation of Flight Attendants, and associates.

Please come forward. I can say to my colleague from Kansas that this is the best part of the day. It's the best portion of the hearing. From previous experience, I can tell you flight attendants come prepared, they're well informed, they care about this industry, they are the first line of safety, and they bring a very special perspective on the needs of the industry, and I'm grateful to have you participating in our hearing. We thank you for your patience through a very long day of hearings.

Let us begin with Ms. Leon.

TESTIMONY OF CHERYLE LEON, PRESIDENT, ASSOCIATION OF PROFESSIONAL FLIGHT ATTENDANTS; DAVID BORER, DIRECTOR OF COLLECTIVE BARGAINING; BRIAN MOREAU, PRESIDENT, INDEPENDENT UNION OF FLIGHT ATTENDANTS; AND VICTORIA FRANKOVICH, PRESIDENT, INDEPENDENT FEDERATION OF FLIGHT ATTENDANTS

Ms. LEON. Good afternoon, Mr. Chairman and the committee. I am Cheryle Leon, President of the Association of Professional Flight Attendants. APFA represents 18,000 flight attendants at American Airlines. I welcome the opportunity to testify before you today. APFA appreciates, Mr. Chairman, your longstanding leadership along with that of the subcommittee on issues concerning the economic vitality of the airline industry.

I am here today to discuss briefly why and how carrier/labor relations present the single greatest economic challenge facing the U.S. airline industry now and for the decade to come. Simply stated, strong employee morale is fundamental to the financial health of the airline industry, because this is the only way to achieve acceptable employee productivity. While sharp hikes in fuel prices, security concerns, and pilot labor shortages all related to the Persian Gulf war have contributed to the worsening financial condition of American and other carriers, the Persian Gulf war threatens to distract our attention from the more basic reason underlying poor domestic industry financial performance—employee morale.

In the case of APFA, we have faced threats of job losses from the increasing employment of non-resident aliens, termination and other forms of harassment over our weight, and refusal to grant us minimally acceptable CRAF agreements so that we may fly our troops to the Gulf. Our carrier takes the view that CRAF flying does not differ from any of their international trips and even refuses to give us gas masks or other safety equipment, protective clothing, for flights to Saudi Arabia.

Since deregulation and especially since the Department of Transportation assumed the functions of the Civil Aeronautics Board in

1984, we have witnessed declining employee morale. One of the devastating hallmarks of deregulation has been the systematic demoralization of one carrier's employee group after another. In remarks before the National Press Club on January 23, Secretary Samuel Skinner made a cynical attempt to blame labor for the demise of Eastern and the difficulties of the airline industry in general. He was far off the mark.

The facts simply do not bear out Secretary Skinner's conclusions. Some carriers are in trouble despite having given no wage increases in years. For example, TWA flight attendants have not received a raise in the last five years, and the rest of its employees work well below the industry average. Continental, a carrier in bankruptcy, has been at the bottom of the scale for nearly seven years. On the other hand, stronger domestic carriers like Delta, United and American have notably higher labor costs than those in financial trouble. Key foreign competitors, including British Air, Lufthansa and KLM, also have higher labor costs than their U.S. counterparts but are neither economically distressed nor harming their customers with excessive fares. Far more basic concerns about job security, deteriorating working conditions, and aviation safety have undercut U.S. aviation employee morale, productivity and profitability.

By alluding to high wages and excessive union power, Secretary Skinner showed that he is quite out of touch with actual conditions in the industry today. For the past decade, aggressive corporate policies have put unions on the defensive and eroded pay and working conditions. By focusing on the supposed excessive power of airline unions, Secretary Skinner ignored what we see as the real problems. While DOT is preoccupied with expanding foreign ownership of U.S. carriers, it has adopted a do-nothing approach to health and safety issues such as cabin air quality and radiation levels.

For example, DOT and the FAA insisted for years that Eastern Airlines had no discernible safety problems despite overwhelming evidence from employees to the contrary. It took an independent grand jury's criminal indictments to demonstrate what DOT and FAA could have uncovered with reasonable diligence. Ignoring these employee complaints sent a clear signal to every airline worker in the country that legitimate safety concerns should not be forward to the Government since they would be seen as nothing more than labor disputes, a favorite DOT term whenever employees try to identify carrier mistakes to public officials.

I would suggest that such an attitude on the part of the Federal Government may be related to a decline in airline safety. Except where Congress has required regulatory action, as in the smoking ban, we have seen complete DOT and FAA stagnation on many basic employee concerns about safety and health that fall solely within DOT and FAA jurisdiction, such as duty time and rest limits for flight attendants. Imagine the message it sends to all U.S. flight attendants when DOT stone-walls for nearly eight years on rules needed to assure adequate rest and reasonable work limits for us when some 23 other countries already have them.

While DOT has implicitly sanctioned unfair company policies on flight attendant weight, it has ignored our efforts to impose weight restrictions on serving carts responsible for back injury.

The continued weakening financial condition of the airline industry foretells increased concentration in the industry. Even at the larger survivors like American, however, long term financial health is far from certain until our systemic problems are resolved. To do this, the Federal Government must consider a number of key measures.

First, United States cabotage laws should not be changed to allow foreign airlines authority to provide service between United States cities. DOT has taken an increasingly positive position on easing cabotage rules without considering the consequences for U.S. airline workers. Allowing foreign carriers greater access to the U.S. market could endanger the jobs of thousands of U.S. employees. Such changes would undermine the policy goals served by current requirements that U.S. carriers employ only U.S. citizens or permanent residents in such service. Displacement could cause a large number of U.S. jobs to be lost in States like Minnesota, which borders Canada, and Texas and California, which border Mexico. We all know that current Mexican wages are too low for us to compete with them. The Transportation Department should spend less time extolling competition and pay some attention to the possible impact of the change in cabotage policy.

Second, each transfer of international routes should be evaluated on its own merits. Critical to the thorough evaluation of a given route transfer is the availability of information concerning the impact of such transfers. DOT and the carriers' longstanding policy of shrouding all basic information about the transfers in the cloak of confidentiality not only stops employees from full meaningful participation in DOT route transfer proceedings but also undermines Congress and the public's ability to determine whether transfer of these routes serve the national interest. APFA has recently requested that DOT require that American Airlines and TWA voluntarily share important information about the London route transfer with the public and their employees.

Third, APFA believes that international route transfers often jeopardize the jobs of thousands of employees. This can cripple vitally needed morale and productivity at the selling carrier while creating vast job uncertainty at the acquiring carrier. To solve this matter once and for all, APFA supports the transfer of jobs with routes. American and APFA successfully accomplished such transfer of jobs with routes in our Air Cal merger.

Fourth, before labor/management disputes threaten a vital national concern such as the aviation industry, the DOT should intercede far more frequently and aggressively to insist on rapid and equitable settlements. The leadership of former Labor Secretary Elizabeth Dole in resolving the Pitts and Cole United Mine Workers dispute exemplifies the role Government should play in using political leadership effectively to advance national interests.

Fifth, DOT and FAA should issue long-delayed regulations establishing limitations on flight attendant duty times, take the necessary steps to standardize flight attendant training, and issue regulation which would improve cabin air quality. Such concrete action would provide recognition that aviation professionals, particularly flight attendants, perform vital safety and security functions and would provide a tremendous boost to employee morale.

Most of these problems call for Government oversight, not better bargaining. The Federal Government should exercise leadership and cross over partisan boundaries to bring labor/management peace by stimulating employment stability and safety in the work place. These elements are essential to improving employee productivity. Good employee morale and high employee productivity are basic ingredients to restoring vitality to the domestic airline industry.

If there is a labor problem in the airline industry today, it is that workers increasingly feel they alone are being made to bear the burden of change. An industry that depends so much on personal service cannot afford to pursue policies that erode employee spirit and commitment. Decent treatment of workers is one of the keys to the revival of the industry. Addressing these concerns responsibly now will enable the rest of the airline industry's problems to take care of themselves.

Thank you, and I will answer any questions you may have.

Mr. **Oberstar**. Thank you very much. You've certainly addressed a wide range of concerns that we are exploring in the course of these hearings, and we appreciate your testimony.

Mr. Borer?

Mr. **Borer**. Thank you, Mr. Chairman.

Chairman Oberstar and members of the subcommittee, thank you for the opportunity to testify today. My name is David Borer, and I am the Director of Collective Bargaining for the Association of Flight Attendants, AFL-CIO. I am here today on behalf of the 30,000 flight attendants AFA represents at 18 U.S. carriers. As director of AFA's collective bargaining department, I have been on the front line of the union's dealings with the airlines, and I hope my comments will be useful to the subcommittee.

I will first address the issue of the adequacy of the competition in the airline industry and then devote the remainder of my remarks to the question of the airlines' financial condition.

On the question of competition, to put it bluntly, competition in the airline industry is a myth. Of course, there is a measure of competition in certain key markets, but the storm of competition forecast by proponents of deregulation over 12 years ago is scarcely a memory. That fiction is betrayed by airline managers who, while jabbering endlessly in public about the benefits of deregulation for the consumer, spend most of their waking hours pursuing increased market share.

The three most aggressive U.S. carriers—United, American and Delta—have succeeded in gaining control of nearly 50 percent of the market. Over 92 percent of the market is controlled by just eight carriers. Since deregulation, the industry has seen approximately 50 mergers and 200 bankruptcies, with more to come. It is unassailable that the industry was less monopolistic before deregulation than it is today.

Like competition in general, price competition survives primarily as a myth. Airline executives have no doubt tried to impress this subcommittee with claims that over 90 percent of the passengers today travel on discount fares. That statement is nothing more than a PR gimmick. In theory, pricing is fairly simple in the airline industry. Airlines attempt to charge the highest possible price for each seat at the time it is sold and still have the aircraft depart with every seat filled. In reality, a full fare is only what the airline charges for the last few seats that it knows it can sell at the last minute before departure to passengers who must travel despite the high fare. I would venture to say that except in certain limited markets almost no tickets are sold at a true discount below the highest fare that the airline believes it can charge on a given day.

Even the talk of a return to service competition has faded in recent months. Since they no longer could brag that they were competing for passengers by offering competitive fares, airline executives began to talk about competing by offering better service. Any frequent flyers in the hearing room would probably agree with me if I predicted that the airlines will soon adopt another Reagan-Bush Administration policy that is classifying ketchup as a vegetable.

Let me turn now to the issue of the current financial condition of the airline industry. Among carriers where AFA represents the flight attendants, Braniff and CC Air are currently in bankruptcy, while both Braniff and the Eastern Metro Express have ceased operations. Other AFA carriers, such as Midway, Hawaiian and U.S. Air, are reporting huge losses as analysts debate their ability to survive. AFA-represented flight attendants have been through nearly uncountable numbers of mergers and acquisitions since deregulation, including North Central and Southern; Republic and Hughes Air West; Republic and Northwest; Western and Delta; USAir, PSA and Piedmont; Alaska, Jet America and Horizon. All of those just in the short time since deregulation.

Each bankruptcy, each merger and acquisition, each financial crisis brought on by poor management—each one of these has exacted a very heavy toll among the flight attendants and other workers involved in the form of lost wages, dislocation and lost jobs. Carriers that are struggling financially often have come to AFA and the flight attendants we represent demanding concessions to help cover the financial problems. Flight attendants have agreed to pay cuts totaling more than half a billion dollars in 22 concessionary agreements at 12 airlines since 1981. Approximately 27,000 flight attendants, over one-third of the flight attendant work force, have been directly affected by these cuts.

When pay freezes, work rule concessions and the results of establishing the B-scale wages are added to these outright pay cuts, Flight attendants collectively have given up more than a billion dollars in lost earnings since deregulation began at those carriers. Yet even these immense sacrifices by flight attendants have done little to stop the inexorable march of bankruptcies and mergers.

Somewhat predictably, airline executives blame labor for most of their financial difficulties during the 1980s and 1990s. Secretary Skinner joined this chorus again yesterday in remarks before this subcommittee, citing the airline's failure to bring labor costs under control as one of his four reasons for the current sorry state of airline finances. This despite the fact that flight attendant costs, for example, represent only 4 to 6 percent of U.S. airlines' total operating costs. In reality, flight attendants' pay has fallen behind inflation and behind non-airline worker pay increases.

While airline management and Secretary Skinner blame labor for the industry's problems, labor can more accurately blame management and the Government. Deregulation and poor management are what brought the industry to its current state. Simple bad management has resulted in the destruction of several significant airlines. A never-ending stream of mergers and acquisitions has swallowed up others while creating huge debt loads for the survivors. Adversarial, even belligerent attitudes toward labor have destroyed some carriers while affecting all.

For AFA, bad management is personified by Frank Lorenzo and other airline executives of his type. Frank Lorenzo took on labor at Continental and, through manipulation of the bankruptcy laws, created what everybody refers to as a "low cost carrier." Continental still lost over $250 million in 1987 and over $315 million in 1988, while making a small profit in 1989. I would ask you, is that worth the cost in workers' lives destroyed in personal bankruptcies, even suicides, and the depression of wages throughout the industry? I think not. Other carriers, even profitable ones, have become so bent on fighting labor that paralysis and destruction has become acceptable throughout the industry.

While AFA members have held their own in the face of management intransigence, we have not done so without incident. For example, facing unprecedented bad faith bargaining at Horizon Airlines, a subsidiary of Alaska Airlines, we have been negotiating in vain for nearly four years for our first contract. Meanwhile, AFA flight attendants have been furloughed recently at U.S. Air, at West Air, at Alaska Airlines, CC Air, Midway, and Eastern Metro Express. Our flight attendants are struggling for first contracts at Atlantic Southeast, Eastern Metro Express, Tower, CC Air, and at already-mentioned Horizon. Negotiations at United have dragged on since 1987 with United's flight attendants having no general pay increase since 1986. At U.S. Air, we are in the midst of our sixth contract negotiation since 1986, and we face demands for cuts in pay or working conditions at virtually all carriers where we are currently in negotiations.

Can it get worse than this? Unfortunately, I think the answer is yes. With the future including a global market, foreign ownership and possibly cabotage, things may indeed get worse. Increased foreign ownership and cabotage represent a deadly combination for the U.S. airline industry. Secretary Skinner has recently embraced increased foreign ownership. The plan he suggests summarily changes the protection Congress had created against foreign ownership and control of U.S. airlines. We believe that if we first took the time to consider some troubling questions, we would not go down that path.

For example, will there be any restriction on which countries' airlines may control U.S. carriers? How do we keep foreign governments, which often have great control over their own airlines, from exerting the same control over U.S. carriers? How many U.S. carriers will cease operating because of the loss of markets to foreign-owned carriers? How will foreign ownership affect safety and security, and how will foreign ownership affect labor? How many workers will be laid off? How many flight attendants will go bankrupt? I would urge the Congress to reaffirm the established limits on foreign control and prevent the further destruction of the airline industry.

If foreign ownership is a threat, then cabotage is a menace. We could expect a number of U.S. carriers to be driven out of business by point-to-point competition with foreign carriers in the U.S. domestic market. Since some foreign carriers are owned or subsidized by their own governments, they would hold an unfair competitive advantage over U.S. carriers. The subsidized carriers could undermine the profitability of U.S. carriers and start another round of pay cuts, furloughs and job losses.

Labor is prepared to fight to prevent that from happening, because, as we have seen, any fundamental change in the industry can deeply affect the workers. As the Secretary makes changes in policy like foreign ownership and as he prepares for the Canadian talks or as the Congress considers legislative changes, you must think of the effect these changes have not only on the industry but specifically on the workers in the airline industry.

We strongly believe at the Association of Flight Attendants that the Federal Government should take legislative and administrative action to help the airline industry. We urge you to start by protecting the workers. It is vitally important that labor protective provisions, for example, be granted during mergers. This will protect workers from being laid off without some type of compensation, provide relocation expenses, and provide for a fair process for combining work forces.

In addition, it is essential that H.R. 5, the permanent strikebreakers replacement bill, be passed. As more and more companies force their workers out on strike and then permanently replace them, the collective bargaining system established by Congress is being turned on its head. There is no longer a right to strike in any real sense. Instead, companies and the courts talk about a right not to strike. This has upset the delicate balance of economic power that for many years made the collective bargaining system work efficiently.

We also believe there should be more vigilance on the part of the Government in enforcing anti-trust laws. This will ensure that the remaining competition stays intact and encourage new entrants, thus providing passengers with more choices in reasonable fares while providing flight attendants and other airline workers with some stability.

In conclusion, it is imperative that we save the airline industry, but not at the expense of airline workers. Flight attendants and other airline workers have already lost their jobs. They have been relocated, they have been forced to take concessions, and still the industry is no healthier. Let us not rush into foreign ownership and cabotage with the hope that it will become the industry's panacea. We are here today to say that it will not help the industry. It could in fact destroy the industry and the livelihood of tens of thousands of airline workers.

Members of the subcommittee and Mr. Chairman, thank you again for allowing me to testify, and I will be happy to answer any questions.

Mr. **Oberstar**. Thank you very much, Mr. Borer. We really appreciate your splendid presentation.

Now I'll ask Mr. Moreau to continue.

Mr. **Moreau**. Mr. Chairman and members of the subcommittee, my name is Brian Moreau. I'm the President of the Independent Union of Flight Attendants. Our union represents the flight attendants on Pan Am, Pan Express and the Pan Am Shuttle. Thank you for the opportunity to testify.

As you are aware, all three carriers at which IUFA represents flight attendants are currently operating under Chapter 11 bankruptcy protection. Many of the questions being asked by this subcommittee, therefore, can be answered by us in the past tense.

The subcommittee asked if any major carriers are likely to fail or to sell major assets in order to survive. The answer regarding asset sales is clearly yes. Pan Am is surviving today solely as a result of major asset sales. It sold its non-airline inter-continental hotels and the Pan Am building in New York. It sold its Pacific Airline Division to United and its Inter-German Airline Division to Lufthansa. Its Heathrow route authority is being sold to United and is currently before the Department of Transportation and British authorities for approval. Pan Am Shuttle is on the auction block, and we have reason to believe that it will be sold in the near future. As for the possibility of Pan Am's failure, at some point Pan Am will have no more assets to sell, and the carrier may well be forced into ceasing its remaining operations.

The subcommittee asked if foreign carriers should be permitted to increase ownership in U.S. carriers. To the flight attendants of Pan Am, it would be a sad day for the United States' flag bearer to be substantially owned and operated by a foreign concern, but it would be far sadder still for the carrier to disappear into liquidation. Therefore, for our employees, we see increased foreign ownership as the lesser of the evils.

The subcommittee also asked what are the causes of the industry's financial difficulties, and are these likely to continue into 1991 and 1992? We've already heard of the effects of fuel prices and the effects of the Middle East situation. All of that is true. But I'd like to take just a minute to comment on the remarks made by Secretary Skinner to the National Press Club on January 23. In his remarks, Secretary Skinner deals with the effects of deregulation in one paragraph, lumping together management's failure to adjust to deregulation and the taking on of massive and excessive debt, a vague reference about the responsibility of the investment community, and he continues for nearly the rest of the page to berate labor and labor costs as the cause for the airline woes.

Most assuredly, he can't be referring to Pan Am. Flight attendants alone have either agreed to or had imposed upon them concessionary contracts in the last three rounds of negotiations. We voluntarily agreed to a $16 million a year give-back in 1982, had a $50 million to $60 million a year concessionary package imposed on us in 1985, and in 1989 we voluntarily agreed to another $32 million a year in concessions. The other unionized employees of Pan Am have given similar, or in some cases greater, concessions. We have given at the office, and the carrier has still gone bankrupt.

In Pan Am's case, Mr. Skinner neglects to recall that it was the United States Government that prohibited Pan Am from operating a single route within the United States for nearly 50 years. Pan Am effectively was forced to build its hubs overseas. Currently, with the adoption of domestic deregulation, the Government began awarding routes from more internal U.S. cities to foreign destinations. More often than not, the awards went to those U.S. carriers with already established domestic hubs—for example, Delta in Atlanta and U.S. Air in Pittsburgh. Pan Am, having been kept from the domestic U.S. operations for so many years, was at a distinct competitive disadvantage. DOT next began to allow foreign carriers greater access from their foreign hubs to destinations within the United States.

All of these Government decisions had the effect of continually eroding Pan Am's passenger base, and now the possibility of cabotage is being debated. Envision, for example, a Mexicana hub in Houston, with pilots and flight attendants being paid the prevailing wage in Mexico. It will only be a matter of time before U.S. carriers demand that their U.S. employees lower their wage rates to compete.

While there is some evidence that consumers might enjoy some temporary benefits from these Government actions, Congress and the Administration nevertheless should acknowledge the direct effect that Government actions have had and continue to have on U.S. carriers, and specifically our carrier, Pan Am, and its employees.

The subcommittee has asked if financially weak carriers should be allowed to sell international routes. It is unfortunate that at Pan Am our continued survival may require that such sales be allowed. Pan Am tells its employees, with reason, that the cash receipts from United as well as the proceeds from the sale of the shuttle will be required to continue operations. We do not want to see our carrier sold off in pieces, yet we face the possibility of the total loss of employment if these sales are not allowed. However, we should not forget that when there are only a few mega-carriers left, which appears to be more likely with each passing day, the consumer will begin to bear some of the burden that employees have so far carried alone.

I would like to conclude by reporting to you on the effects of the international route sales on the employees of Pan Am. The Department of Transportation has refused to consider the effects of such sales on our employees. The Department has said that unions must negotiate directly with their carriers to alleviate the detrimental effects of mergers, route sales, and DOT decisions. Let me tell you what that means in the real world. It means that thousands of airline employees have already lost their jobs, and thousands more will follow. The Department does not tell us how we can negotiate with United Airlines over the effects of its purchase of our London route.

It takes approximately 700 Pan Am flight attendants to operate a full summer schedule of flights into Heathrow. How do we negotiate with United when we have no legal entitlement to do so? Indeed, the Association of Flight Attendants, AFA, has the exclusive statutory right to bargain with United on behalf of flight attendants employed by that carrier. We have no such right. So in the meantime, 400 London-based Pan Am flight attendants and 102 Washington-based Pan Am flight attendants and 3,500 other Pan Am employees this week have been given furlough notices. United said that it may offer employment to some London flight attendants but only at entry level wages with low seniority. How are we to negotiate something different with United?

Next the DOT tells us to negotiate with our individual carriers for protection. We did. We negotiated what is called in the industry a scope clause. Here are the results of that agreement. One portion of the scope clause says that all flying performed by Pan Am Corporation must be done by our members. The company soon began court challenges to stop our efforts to enforce it. So far we have been able to arbitrate only one of many job assignment disputes, because most courts have ruled that our agreement is unenforceable. Not that the company didn't agree to job protections, simply that the agreements themselves could not be enforced either through arbitration or through the courts.

Most recently, one appellate court has ruled that the provisions of the Railway Labor Act do not apply to foreign-point-to-foreign-point flying, and therefore our scope clause in essence is unenforceable as to that flying. For a work force that has done foreign flying almost exclusively, it is startling to be told by the courts after 60 years that our contract can't be enforced.

We also negotiated the requirement that Pan Am give a 60-day notice of base closures. Our London base is being closed with just over 30 days' notice. We will have to fight for enforcement of those negotiated benefits again. And our final negotiated job protection, payment of enhanced severance pay in the event of furloughs resulting from route sales, has been weakened substantially by Pan Am's bankruptcy filing. After a three-year process, an arbitrator finally ruled that Pan Am was required to pay "scope" severance pay to our flight attendants who were furloughed in San Francisco as a result of the sale of the Pacific Division to United. Apparently, Pan Am considers these monies to be a pre-petition bankruptcy claim, and we will now have to fight in the bankruptcy court to recover those negotiated benefits.

Without fail, the Department of Transportation steadfastly refused to impose even the most minimal labor protection provisions in route sale cases, even though it has the ability, if not the obligation, to do so. The results have been that more senior employees, the employees who spent most of their working lives establishing the very routes that are being sold or transferred, are out of a job. The acquiring carriers then come in and employ new hires to operate the same flying at substantially reduced wages with reduced benefits.

But, of course, this applies only to United States workers. United is protecting the jobs of the British ground employees in its purchase of Heathrow authority and is even planning to advertise for local English employees to fill some flight attendant positions in London. American Airlines offered employment to all South American-based employees, including foreign flight attendants, when it took over Eastern's Latin American routes, but no U.S. employees were offered jobs. Foreign employees continue to work for U.S. carriers; only U.S.-based employees have lost their jobs. Is this considered in the public interest?

Department of Transportation negotiators who are fighting Pan Am and United's battles with the British apparently are ready to make major concessions in the approval of the Heathrow transfer. We can only wish that the United States Government would give similar consideration to our employees.

We ask that this subcommittee and other committees of Congress look seriously at the effects that the regulation of route sales and DOT decisions are having on the United States work force. Strong airlines will become stronger, and weak airlines will become weaker. Some consumers may see temporary gains, but the employees of the U.S. carriers will again be left without protections and without jobs.

Once again, I appreciate the opportunity to appear here today.

Mr. OBERSTAR. Thank you. You've certainly covered a wide range of issues there and some very serious problems. As a footnote or a punctuation mark to your testimony, I just received notice that the Department of Transportation has issued its final order approving the Pan Am-United route transfer into London. We can pursue that further in a moment.

Ms. Frankovich?

Ms. FRANKOVICH. Thank you.

Mr. Chairman, members of the subcommittee, my name is Victoria Frankovich, and I am President of the Independent Federation of Flight Attendants. We represent the 7,000 flight attendants at TWA. We welcome this opportunity to discuss several alarming trends which are emerging in the United States airline industry.

Let me emphasize at the outset that TWA employees have an interest in the continuing viability of TWA. Our concerns about maintaining competitive airline services mirror those of the traveling public and the communities that TWA services. TWA can survive, but not under the current Department of Transportation policy of rubber-stamping route transfers. The DOT has adopted a view that the Government should not interfere with the decisions of airline managements. IFFA strongly believes that the public interest, which the DOT is responsible for protecting, includes the interest of corporate stakeholders—communities served the airlines, the traveling public, who will face higher fares and less service, and the employees, who have devoted their lifetimes to the major airlines and are now threatened with extinction.

The airline industry today is divided into the haves and the have-nots. Acquisition of profitable, limited entry international routes by the largest carriers could shortly eliminate airlines that are selling routes and diminish the economic viability of those carriers that could not even compete in the bidding wars. Many are likely to first sell their assets and then inevitably fail. This dim prognosis is not likely to change in the short term unless the Department of Transportation adopts a comprehensive regulatory policy to deal with the fundamental causes of the industry's financial difficulties.

The problem in the industry today is leverage, not labor. Recent attempts to make labor unions a scapegoat for the rapid consolidation of the U.S. airline industry do not comport with reality. The highest paid employees are those of the financially strongest U.S. carriers. Moreover, the labor cost of U.S. airlines are lower than those of European and Canadian airlines.

At TWA, employees enabled Mr. Icahn to acquire the airline, and the airline was able to post impressive operating profits because of TWA wages, which are now amongst the lowest in the industry. TWA employees have paid to make TWA competitive with other airlines, but the benefits of the bargain have not been realized. The leveraged buyout of TWA by the Icahn group in 1988 ensured that operating profits generated by airline operations would be wiped out by the massive amounts of debt that the airline was forced to assume. At the time, TWA employees expressed their concern that the leveraged buyout was a pretext to begin the systematic liquidation of TWA operations through route sales which were routinely being approved by the Department of Transportation.

Unfortunately, subsequent events have proven that these fears were well founded. The Department of Transportation recently approved the sale of TWA's Chicago-London routes to American Airlines. Far more troubling is the pending application to sell TWA's remaining London route authorities, Chicago gates, and other transatlantic authorities. At TWA and potentially as well at other financially stressed airlines, the assets and routes that are being sold are the ones that contribute to the airline's profits that are needed to service the airline's debt. Sales of vital international routes and valuable airline assets do not allow airlines to survive. With fixed debt and diminished revenues, operating losses will mount.

At most, asset sales postpone the day of reckoning if the fundamental problems are not resolved. Unless the Department of Transportation deals with the root causes of the industry's financial difficulties, it is likely to pursue policies which will eradicate the consumer benefits which the DOT claims have resulted from vigorous competition under airline deregulation.

In unregulated industries, management has no Government licenses to sell to generate cash to service debt. These companies and their lenders are motivated to reorganize operations, restructure debt, sell the company as a going concern, or, if all else fails, seek the protection of bankruptcy courts to redress their financial difficulties. Efforts at corporate restructuring can be successful if the company maintains its productive assets.

Despite the deregulation rhetoric, the route transfer policies enunciated by the DOT constitute a form of special regulatory largess by which private concerns are permitted to sell government-created assets. The result is contrary to the stated aims of the Airline Deregulation Act. The most valuable assets will always go to the highest bidder, which is also invariably one of the largest airlines. This contributes to the trend toward unacceptable industry concentration. DOT regulatory policy also discourages changes in ownership or defers corporate restructuring until it is too late and until liquidation is then the only answer.

IFFA does not mean to suggest that all route transfers should be forbidden. The problem is that the DOT decisionmaking process governing sales of international routes appears to be motivated by panic and not by reflection. The mere threat of bankruptcy seems to be a sufficient ground to secure what is in effect an exemption from the public interest review that the Department of Transportation is required to perform under the Federal Aviation Act. Congress has instructed the DOT to promote airline competition in all its regulatory functions, yet when reviewing route transfer applications, the DOT concludes that the desires of carrier management always outweigh the interest of the communities, the traveling public, and airline employees.

It is perhaps reasonable to suppose that airline managements would make better decisions about markets to serve and prices to charge than regulatory agencies. However, professional airline managers would not choose to cannibalize their most valuable operating assets but for financial pressures that have been created by inordinate amounts of debt. The DOT's decision not to consider seriously the financial condition of airlines either as a part of ongoing fitness obligations or in the context of a route transfer case has led to a situation in which airlines will come under increasing pressure to sell government licenses, leaseholds at congested airports, or slots at controlled airports, wherever there is an economic downturn.

While no one can deny that the Persian Gulf crisis has contributed to the financial woes of certain carriers, it does not follow that sale of international routes is the answer. Route sales should be the last response to financial pressures after other sources of equity and debt have been exhausted. At TWA, the route sales are the first response. In 1988, TWA employs warned that the leveraged buyout of TWA to bring it under the private control of Carl Icahn left the airline vulnerable to recession, to fuel price increases, both of which we all know are commonplace in the industry. It is unclear the extent to which the resultant debt and other intracorporate transactions involving the Icahn group may be contributing to the claimed financial problems of TWA today.

We do know that in April of 1990, TWA filed an exhibit in a route proceeding, claiming to have $1.159 billion in cash and liquid assets. More recently, in sworn testimony Chief Operating Officer William Hoar stated that TWA had plenty of cash. We do not dispute that TWA is losing some money today; however, TWA employees fully appreciate that with the sale of TWA's vital transatlantic authorities, TWA cannot make money in the future.

Are TWA's long term prospects as an airline being sacrificed to protect Carl Icahn's cash and position in USX stock? What assurances is there that, having once realized the value of TWA's international routes through route sale, Carl Icahn will not simply liquidate the airline? Have TWA assets been sold to other Icahn-controlled companies, and if so, on what terms?

To date, DOT has erroneously declined to address these questions by dismissing the serious issues which they raise with the perfunctory claim that the DOT need not involve itself in what it calls management/labor disputes. But DOT has chosen sides by deferring to carrier management instead of performing an independent, factually oriented analysis of the public interest. It is not too late for TWA, but it soon will be if DOT hastily approves the transfer of TWA's vital transatlantic route authorities and assets at various U.S. airports.

The trend toward liquidation of U.S. airlines is likely to continue and accelerate because sale of vital assets will necessarily diminish an airline carrier's long term viability in the absence of an alternate plan of airline operations. If it is unable or unwilling to resolve these issues, the Department should decline to approve a route sale, thus preserving for the bankruptcy court maximum flexibility to reorganize the airline, and address the issues concerning the propriety therefore of corporate transactions.

The Independent Federation of Flight Attendants approaches the issues of foreign ownership and cabotage, another issue you requested that we address, with great caution. A larger degree of foreign ownership may permit a U.S. carrier to continue operating with U.S. employees under economic and safety regulations that pertain to U.S. flag carriers. This seems to us to be a more satisfactory solution to current financial difficulties some of the carriers are facing than losing both the airline and the U.S. jobs.

Continued consolidation in the U.S. airline industry will inevitably have adverse economic effects on cities that once enjoyed benefits of airline deregulation. Hub airports such as St. Louis currently enjoy levels of service that would be lost if TWA is allowed to liquidate. These cities can look to become mere spokes to another carrier's hub if the trend toward consolidation continues unabated. The loss of airline jobs will also affect the local economies of a number of airline competitor contracts.

IFFA is concerned that loss of airline services and increase in prices will lead cities and airline passengers to demand expanded access of foreign carriers to domestic U.S. markets. This is no solution to a problem that can be avoided by preventing further erosion of the U.S. airline industry.

The committee has asked whether there should be any re-regulation of services or rates of the airlines. Implicit in this question is the assumption that increased concentration in the airline industry will require remedial legislation. As long as the DOT is sufficiently mindful of its responsibility to promote competition in discharging its current regulatory functions, we believe this issue does not need to be addressed at this point in time.

Congress recently amended section 401(h) of the Federal Aviation Act to impress upon the DOT its obligation to carefully consider the long term competitive implications of its decision to approve route transfers. IFFA, as well as a number of civic and labor parties, has submitted extensive comments to the DOT, establishing that the proposed transfer of TWA's transatlantic operations and Chicago facilities will inevitably result in its elimination as a U.S. airline. Given Mr. Skinner's reaffirmation of the DOT's commitment to preserving airline competition, we are hopeful that the DOT will carefully consider the application of these standards to the joint application of American Airlines and TWA, in which case we are certain it will be denied.

However, DOT's discussion of the requirements of this new legislation in the context of several recent cases causes IFFA to question whether or not the DOT actually intends to implement the Congressional directives to consider the effects of route transfers on the domestic U.S. airline industry, the viability of each carrier party to the transaction, and the competitiveness of the U.S. airline industry in foreign markets. Congress may wish to consider further legislation to ensure compliance with the spirit of the new law.

If DOT adopts policies that do not maintain the competitive viability of the airline with which an employee is currently serving, then IFFA believes that some form of relief must be fashioned to avoid undue hardships to the employees of the failed airlines. The promises made to airline employees in connection with the deregulation have not been kept. At a minimum, employees should enjoy the right of first hire, which had been part of the Deregulation Act, although, as we all know, it likewise was never enforced. A more equitable requirement would be to ensure that people who are performing a function today go with the jobs that are being transferred. TWA flight attendants are highly skilled and experienced personnel. Despite years of loyal service, they enjoy no preference in hiring at American Airlines under either the Chicago route transfer or the remaining United States-United Kingdom pending route transfers and will lose wage seniority and certain pension benefits.

The DOT has steadfastly refused to impose the so-called standard Allegheny-Mohawk labor protective provisions for close to a decade. During this time, Congress has attempted to legislate these benefits on a number of occasions but without success. IFFA urges the subcommittee to consider enacting limited job preservation legislation that would provide the first right of hire to employees who have served on the routes to be transferred. These employees should be permitted to retain their seniority for purposes of bidding on routes, to maintain their existing levels of wages, and to credit their years of service toward vesting in the pension plan.

I have only a couple more comments. Since the airlines selling routes have all secured wage concessions from employees, the employees transferring with those routes would be in all likelihood less costly than any similar experienced flight attendants at the acquiring carrier. We think this is an important point that can be considered in fashioning a remedy to try to protect employees.

Let me emphasize again that IFFA's primary objective is the preservation of TWA as a viable carrier. We are troubled that the DOT is no more sympathetic to airline competition protection than it is to labor protection. In that event, not only TWA employees but also a number of communities and airline passengers will suffer economic harm from the resulting decline in airline competition.

Mr. Chairman and members of the subcommittee, the employees of TWA thank you for this opportunity to testify on the issues that we feel will very likely determine the fate of TWA and the future of TWA employees. Thank you.

Mr. OBERSTAR. Thank you very much, Ms. Frankovich, for a very comprehensive review of the issues that we asked you to address as well as others that are certainly of very great concern to you on the firing line in the industry.

What will be left of Pan Am if any further action is taken? The route inside Germany has been sold now to Lufthansa, and whether the new Germany would have allowed that route to continue, given the degree of government ownership and control of Lufthansa, is problematic or questionable, but the fact is that that was a marvelous situation for Pan Am to be in, a tremendous growth market. The Japan route is gone, the London route is gone, the Shuttle is on the block. What's left of the carrier?

Mr. **Moreau**. Pan Am has an Atlantic Division that will remain without Heathrow, which is the $500 million a year revenue producer, and Latin America, and that would be it.

Mr. **Oberstar**. And it has no domestic route development network to feed those international routes. It has only its great name and great history and presence as a representative of the U.S. flag to go on. What becomes of it then? Is that viable, what you described?

Mr. **Moreau**. Unfortunately, it will not be viable, especially in today's state of affairs with the price of oil and the Middle East situation. Pan Am does not appear to be a viable carrier after the sale of Heathrow.

Mr. **Oberstar**. So why sell Heathrow?

Mr. **Moreau**. I think it came down to a question of continuing operations to today, up to this point, with that cash as opposed to shutting down operations a week or two or three ago.

Mr. **Oberstar**. Do you know when the Pan Am pension plan began to go into deficit, if you will—into the status of a large unfunded liability?

Mr. **Moreau**. The Pan Am pension plan has been underfunded since before I came on board, so it started happening somewhere in the 1970s.

Mr. **Oberstar**. Around the time of or just after deregulation? Yes, says a knowledgeable voice of experience at the back of the room. [Laughter.]

Mr. **Moreau**. That would be about right.

Mr. **Oberstar**. That burden of debt, from my experience, has been the principal impediment in a much more productive management of Pan Am's assets—merger with another carrier or even acquisition by Pan Am of another carrier that would have given it a domestic route capability and sustained its operations. That certainly is a tragic circumstance.

You suggest, though, or seem to suggest in your testimony, that foreign investment in Pan Am might be a solution, at least for its employees, perhaps not to the grand benefit of service in the United States, although I think I would have probably less concern about cabotage resulting from a large foreign investment in Pan Am than in a U.S. carrier that has a large domestic route system. Are there any indications that a foreign carrier is interested in that kind of investment in Pan Am?

Mr. **Moreau**. I would have to report that today probably not, based on the world situation and continuing deterioration of Pan Am's financial condition. At some point in the past, I do believe that would have been true, but I think that interest has since gone away.

Mr. **Oberstar**. I would like to come back to this. I was shocked that American is not providing any gas masks for flight attendants flying CRAF routes.

Ms. **Leon**. Correct. We are currently trying to negotiate a CRAF agreement, and one of the issues that we're in dispute about is we would like the carrier to provide gas masks from the European staging city. Currently, I believe, MAC is supposed to when you arrive—and I think even Vicki could even give you an example of what happened to the TWA flight attendants—but when you arrive in Saudi, they're supposed to supply gas masks, but our concern is we've seen CNN, we've seen missile attacks occurring. What if that MAC person cannot get up the stairs to the aircraft and get you your gas mask, or what if they're not available?

We want to see our members provided with that out of the European staging city so they know it's on the airplane and they are familiar with the use of that and the protective clothing, and that is one area that we are in disagreement. They will not provide it at this point.

Mr. OBERSTAR. That just doesn't seem to make any sense. You're flying into a combat zone, there is a clear and present danger even though the——

Ms. FRANKOVICH. The airlines do not believe we are flying into combat zones, and although we have suffered a number of red alerts at this point, they continue to say that Saudi is not a war zone, and therefore the question of when you would be issued these pieces of equipment comes into play. Likewise, we are in fact flying a number of the missions, as are other people who are represented at this table. We are receiving the gas mask on landing, but there have been several problems of confusion and distribution and improper sizing, lack of filters, and distribution only of masks and not the entire ensemble. You must have every part of your body covered in the event of a chemical attack, so we share concerns of APFA in this regard. We have been attempting to talk to the military and to the carrier, and I have to say the military has been very responsive, but we continue to have difficulties in this regard.

Mr. OBERSTAR. I'm surprised that the carrier hasn't been watching CNN.

Mr. BORER. I think this is a primary example of some of the things you would think could be taken for granted in dealing with these carriers, and they just aren't. This is one example. Hawaiian Airlines flies a lot of charters over there. They've had the same experience with having the plane met in Saudi. Sometimes meeting the plane with the equipment means a military vehicle drives out and parks nearby with the gas masks and other equipment just to be handy but not actually distributed, because that would be too much trouble.

We negotiated for weeks, really, to resolve some of these problems with United Airlines. Tower Airlines, as far as I know, is the only carrier that has actually fired someone for refusing to take a trip into the Middle East. I could be wrong, but they have one person that was fired for that, and that's because they don't, like other carriers, do it on a voluntary basis.

Some things that you would really take for granted in this sort of a dangerous situation the carriers really are dragging their feet, and I have to say our experience has been actually better with the military, the military people have been very cooperative in trying to get us the information and help us deal with the carriers on these things, but it has not been automatic at all.

Ms. **Leon**. Mr. Chairman, on February 4, I received a letter from American Airlines, and I'll quote you, about our CRAF negotiations. "In point of fact, American's CRAF flying obligations do not subject our flight attendants to hazardous duty." That's their attitude.

Mr. **Oberstar**. Well, I think they need to stick their head out the window and take a look at what's going on over there in the Middle East. Maybe they believe reports that all those cardboard SCUD missile batteries have been blown up. Only the real ones are left. Absolutely astounding.

Mr. Clinger, do you have some questions?

Mr. **Clinger**. Thank you, Mr. Chairman. I agree that is a little exotic, to say the least.

My interest is in this question of international route sales and the suggestion that perhaps they should be prohibited altogether in view of the fact that, as you've indicated, where they are sold it is not necessarily the best carrier able to sustain those routes when the carrier who has them is leaving the field, and isn't there a public interest involved in having the Department of Transportation really make the determination?

Ms. **Frankovich**. Mr. Clinger, in our case, that is exactly what happened. We recently had Manchester route discussions, and the route was granted to TWA after TWA made extensive arguments that American was not the proper recipient of the route. For any number of reasons that they argued successfully, TWA was granted the route and turned around immediately and sold it to American. Now, if it were the Department of Transportation's determination that American was not the proper carrier to be serving that route, is it between American and TWA to make the decision that in fact it is American who will have that route?

Mr. **Clinger**. That's what I'm really questioning. It seems to me that we're going at this a little backwards. It seems to me it makes much sense to have some sort of the public interest represented in making those determinations as to who is going to do that.

Any other views?

Mr. **Moreau**. In the Pan Am case, it's the Heathrow routes that are getting all the attention, but we're not talking about a route; we're talking about routes from New York, Washington, Los Angeles, San Francisco, and Seattle to London, several routes, and what's going unnoticed is that Pan Am also sold all of its international route authority to United, even dormant route authority that we're not using now—Washington-Paris and other routes—so it's much more than just Heathrow. Pan Am sold a phenomenal amount of route authority, including the around-the-world route, which is the only one is existence for a U.S. carrier, and we did it to one carrier.

So it's hard to imagine that United may have been the best carrier for, let's say, Los Angeles-London. Perhaps that's correct, but how about New York-London or how about Washington-Paris? There are a phenomenal amount of routes being transferred in this one transaction.

Mr. **Clinger**. Mr. Moreau, on the Pan Am situation, which is, obviously extreme, as you've indicated, the selling off of the Heathrow Route is maybe going to be the final blow, but isn't that almost inevitable anyway, given the fact that you really didn't have the domestic routes to service your entry ports and therefore were having trouble getting domestic passengers on ongoing routes overseas?

Mr. MOREAU. Certainly, the lack of a domestic system was one of Pan Am's major problems and continues to be. There is a line of reasoning that Pan Am's survival had to come through route sales or a merger of the entire carrier. In fact, our carrier tried to merge with Northwest. The thinking is that with Heathrow being gone now that the value of the carrier as a merger as a whole has been greatly diminished; therefore, the survival of Pan Am without Heathrow is greatly diminished as opposed to the possible survival——

Mr. CLINGER. I see. In other words, you were saying that at one point it could have been sold as a going concern, and what you're faced with now is perhaps just cherry-picking or selling off assets. Okay.

I was not here to hear all of your testimony with regard to the foreign investment situation. I'm sorry for that. But I would gather that you might feel that whereas foreign investment has to be looked at very, very carefully, if there was a question of the airline going out of business because of a failure to be able to identify and utilize capital in this country, you would look to foreign investment as a way to address that, if the choice is staying in business or going to foreign capital.

Ms. FRANKOVICH. From our perspective at TWA, we do look at it very cautiously, but our primary concern is the jobs. That's why we are very concerned about the issue of cabotage, and if there are considerations for foreign ownership providing foreign capital that may in fact allow the perpetuation of a carrier and the perpetuation of the U.S. jobs, then we think it must be considered. At the same time, we think you must consider retaining the rights of U.S. citizens to fly those routes within the United States and not give that likewise away, because then what happens is we have been defeated all the way around.

Mr. CLINGER. So that you could see a form of cabotage that would require that once the plane entered U.S. air space that that plane would be manned by U.S. crews?

Ms. FRANKOVICH. Right. Perpetuation of the current policy in that regard.

Mr. CLINGER. Okay.

Thank you all very much.

Mr. OBERSTAR. To pick up on that point of international routes, if there is an argument against allowing sale of international routes as a market commodity, then how should they be disposed of? What is the best way to protect the public interests, the interests of the members that you represent, and also to ensure that the value is somehow retained?

Ms. FRANKOVICH. Well, I think from our perspective, if there is a continuation of the possibility of the carrier selling it, we think there must be a more responsible exercise by the DOT of its regulatory function, which is to actually have an open forum hearing on these discussions. We understand that yesterday Secretary Skinner openly admitted that his decision in the TWA-American Chicago route sale was strongly influenced by telephone conversations with Carl Icahn, where he was advised that failing that there would be a declaration of Chapter 7 bankruptcy. That is not supported by the DOT docket or the record.

If that is the case, let the DOT force a development of the record to establish the fact. If that is the rationale on which the DOT wants to make the decisions, it shouldn't be on the basis of a private phone call, where the communities and the employees don't have access. We don't have that same access to Mr. Skinner, and we don't have an ability to counter phone call threats.

Mr. OBERSTAR. Well, in discussions yesterday and earlier today in our hearings on that subject, I said first of all there is a process in the original award of an international route in which the parties interested in serving that route come in and make their case. The department then selects the best carrier for the best public interest and to ensure the best competition. When that route, of which they've got three, is up for sale, it seems to me the department ought to have a further role in determining if not this carrier then what other carrier. There ought to be a process by which the public interest is served by the department reinserting itself into that decision-making and not just let them put it up for sale.

Ms. FRANKOVICH. I think we agree with that, and we're particularly concerned listening to the investment bankers who would cry now that their investment is lost, when they are the ones who encouraged that light bulbs to routes and everything they could think of be leveraged to the hilt. It should have been foreseeable that the end result of that could be that people would not at some point be able to make their payments. We think that the government ends up giving away its authority to make these decisions by allowing the carriers to turn around and leverage things like routes, sell things like routes, and while the overseeing ability is still there, from our perspective it certainly appears that it's not being exercised.

Mr. OBERSTAR. Your testimony collectively and individually on pay cuts for flight attendants over the past several years totaling in the range of half a billion dollars in 22 different agreements didn't stop the bankruptcies.

Ms. FRANKOVICH. That's correct.

Mr. OBERSTAR. So the Secretary's comments yesterday, which have been roundly criticized by a parade of witnesses and a number of Members of Congress on that subject, are certainly not borne out by the realities. I suspect that, as I suggested to an earlier panel today, if wages were one-third or more lower today than they are now, it would be the least of the factors influencing the financial condition of the airline industry.

Mr. BORER. Mr. Chairman, to take the example in my testimony, I cited that flight attendant costs are approximately 4 to 6 percent of total operating costs. If they're 4 percent and the flight attendants gave up 25 percent of their pay or their compensation, that would only have a 1 percent impact on the company's operating costs—not enough in the kind of cases we're talking about to really have any effect whatsoever, and yet it would be a devastating effect on the other end for the individual flight attendant to have that 25 percent hit.

Mr. **Oberstar**. On routes again, I think a complaint was that employees don't have the same access to information as the carrier involved or the department which is reviewing that information. What additional information by category would you want released that would help you have a better insight into the decision-making process?

Ms. **Leon**. Mr. Chairman, in our view, route acquisitions in the past have been very exciting for American Airlines for flight attendants, but when the Eastern Airlines Latin America acquisition came along, it was heralded with how exciting it would be for our flight attendants. Then we find out that's for foreign national flight attendants. Traditionally, historically, only U.S. resident citizens have flown for American. We've flown all the routes. Now American has hired not only the former Eastern foreign nationals, but they went on the street and have hired more, and we are very wary of looking closely at the TWA acquisition, because we don't know what could be in that deal that could harm our members and U.S. residents, job losses going overseas, and without complete information, it's hard for me to make a judgment as to is this a good deal for my members.

Ms. **Frankovich**. We would suggest that those confidential documents that disclose corporate planning in competition on routes and the financial results of the competition on routes be in the public domain rather than under seal so that there could be more open discussion and disclosure.

Mr. **Oberstar**. Thank you.

On cabotage, extending from your experience with the Latin American routes, there, of course, will be continued discussions, since they were already announced, launched, and are under way with Canada on cabotage. One approach to the job issue is or could be that the aircraft may continue in the U.S. or Canada, but the crew should change. There wouldn't be any particular technical difficulty in doing that. I proposed such an arrangement during our discussions with Canadian aviation authorities back in December and with your counterparts in Canada, and after some thought about it, they seemed to warm to the idea—not giving assent, but wanting to think it through—and I didn't ask for a yes or no, I just said, Think is over. Is this a possibility that when Air Canada aircraft lands in Chicago, for example, the crew to fly it on to Phoenix would be an American crew, and likewise when an American aircraft lands in Toronto, it would be a Canadian crew flying it on to Ottawa or wherever?" That is one possibility that certainly would alleviate the concern over job impact.

Ms. **Frankovich**. It doesn't alleviate it, of course. We've met with our Canadian counterparts. They'd like to have both, as we would. We would like to fly into Canada, have U.S. citizens flying, and likewise have U.S. aircraft. Given the difficulty of our current scenario, we're both trying to make compromises that will preserve our jobs. They are concerned about they would like to be able to fly in here and have Canadians fly in here.

Mr. **Oberstar**. Well, I think the Canadian interest would be not to have a wash but to have a growth, and the same thing for U.S. carriers. On the other hand, as a starter, maybe this is something to get people into the process of broader exchange.

Mr. **Borer**. Mr. Chairman, AFA would, I believe, feel that the airlines would likely see that as just a foot in the door for possible expansion on into using foreign nationals in domestic routes, and even before that happened, even this interchange of crews would not eliminate the pressure that that would create on U.S. labor standards. The mere fact that that segment flying into the country was allowed to have foreign nationals on it—perhaps Canada is a bad example, but from a country where the labor standards and pay is lower — would create pressure on the airline to stage more of their operations in a way to take advantage of that and thereby erode our labor standards here in the U.S.

Mr. **Oberstar**. To be sure there are a lot of problems, and I just want to throw as much consideration of factors into these discussions as possible to get people thinking.

Ms. **Leon**. Mr. Chairman, we've been looking at that trying to assess what it would mean, but I think you also have to look at the fact that when you compare Canada, there aren't as many safety questions. I mean, one could look at, say, on January 15, what if an Air Iraq airplane was flying domestically in the U.S., even with U.S. crews? What does that mean? What kind of safety concerns are we talking about?

Mr. **Oberstar**. Certainly. I also understand that on CRAF flights there are foreign flight attendants being used in certain instances.

Ms. **Leon**. Not at American.

Ms. **Frankovich**. Not in our case.

Mr. **Moreau**. At Pan Am, yes.

Mr. **Oberstar**. At Pan Am.

Mr. **Borer**. And I believe at Tower Airlines as well. Tower has a base in Tel Aviv. It's the only foreign carrier still flying in and out of Tel Aviv, I believe, and they use Israeli nationals on those flights. At least on some of those flights.

Ms. **Frankovich**. At TWA, the only foreign nationals are foreign nationals who have properly immigrated and are operating on visas within the United States.

Mr. **Oberstar**. I see. It raises some other kinds of concerns.

Have you taken a position as separate organizations on the matter of domestic routes and fares for some form of re-regulation as an approach to the industry's current or long term difficulties? Or is that something you'd rather leave where it is?

[Laughter.]

Mr. **Borer**. Well, as I said in my testimony, I think fares have not played out the way that we were all promised back in the late 1970s, when we were considering deregulation. I don't think any of these organizations are promoting re-regulation in a total sense that would be a throwback to the days before 1978. What we're advocating—and I won't speak for the others—but I think in general what we're advocating is a cautious approach, an approach where the Government takes a slightly more active role—and I shouldn't say slightly—a more active role without a complete return to regulation.

Obviously, we have an interest in all of our carriers being profitable and competitive and so forth, because that means jobs, and in theory that means our flight attendants benefit, but I think we have seen since deregulation that the marketplace does not adequately regulate whether it's international route sales or domestic mergers or pricing, and there needs to be another look at that now, 12 years after deregulation.

Ms. **Frankovich**. I think we would comment in that regard that we would not oppose re-regulation, but we're also realistic enough not to waste our energy on things that have a slim possibility of success. So the one area that we think has been notably missing is the promise of deregulation to protect employees so that the employees do not bear the brunt of the effects of deregulation. That has not been delivered, and we think that is an area that is a legitimate concern and should be looked at as an issue for re-regulation or protection of some kind.

Mr. **Oberstar**. Thank you.

On a closing note, I want to assure the panel that this subcommittee will act on the flight attendant duty time issue in the face of the abysmal failure of the department and the FAA to respond. We have been led into one promise after another of one date after another for action, and they have not occurred, and we will take action on pending legislation.

Thank you again for your presentation and for your time and effort and concern that you've given and for making a very splendid contribution to our hearing on this very, very complex subject.

[Ms. Leon's prepared statement appears on p. 533.]

[Mr. Moreau's prepared statement appears on p. 574.]

[Mr. Frankovich's prepared statement appears on p. 491.]

Mr. **Oberstar**. The subcommittee is adjourned.

[Whereupon, at 5:30 p.m., the subcommittee was adjourned, to reconvene at the call of the Chair.]

PREPARED STATEMENTS OF WITNESSES

Standard & Poor's Ratings Group
25 Broadway
New York, New York 10004

Corporate Finance Department

TESTIMONY OF PHILIP BAGGALEY
SENIOR VICE PRESIDENT, STANDARD & POOR'S RATINGS GROUP
BEFORE THE HOUSE PUBLIC WORKS AND TRANSPORTATION COMMITTEE, AVIATION SUBCOMMITTEE, FEBRUARY 6, 1991

Thank you, Mr. Chairman and members of the Committee, for the opportunity to speak to you. I am a Senior Vice President in the Ratings Group of Standard & Poor's Corporation. My primary reponsibility is the analysis of airline creditworthiness.

Before I begin my discussion of the airline industry, I would like to highlight some key issues with regard to debt ratings. A Standard & Poor's rating expresses our opinion of an issuer's credit quality in the form of letter symbols. Ratings of 'AAA' through 'BBB-' are investment grade, while those 'BB+' and below are speculative grade. At present, the average rating of U.S. airlines rated by Standard & Poor's is only 'B+', middle speculative grade. This has declined from 'BB', high speculative grade, five years ago. Standard & Poor's regularly publishes criteria and methodology which show our approach for each industry. In addition, once a rating determination is made public, Standard & Poor's publishes the rating along with a rationale describing major factors which led to our conclusions.

Standard & Poor's currently maintains debt ratings on approximately 10,000 organizations in thirty countries, including all of the major U.S. airlines. My comments today will focus on those airlines rated by Standard & Poor's and our knowledge of the air transportation industry.

The present crisis is probably the worst ever experienced by this industry. Considering what U.S. airlines went through in the early 1980's, that is saying something.

The immediate causes of the problem are recession, high fuel prices, and war. By the time these hearings are complete, you will have heard that refrain repeatedly, and I will not belabor the point. Rather, I would like to explain why airlines are so vulnerable to these events and what that implies for the future.

Fuel accounts for 15-20% of an airline's operating costs. There is, unfortunately, very little that can be done in the short run to counteract an increase in price. Over the long run, buying new, more fuel efficient aircraft helps. However, the total cost, operating and ownership, of these planes is more expensive than that of the aircraft they are replacing. This is an important point to keep in mind as we look at the industry's financial condition.

Airlines have responded by raising fares, but the the added revenues generated fall far short of what is needed. Leisure passengers, who account for more than half of the total, are highly sensitive to price. Raise ticket prices, and they stop flying. Business travelers are more willing to pay the higher fares, but in the midst of a recession even they are cutting back.

With fuel prices jumping and revenues lagging, some airlines have reduced service. However, this is not particularly efficient and suitable only as a last resort. Stop offering a particular flight and you lose the remaining passengers still willing to fly. Furthermore, an airline route system is an integrated network. Cut back in one place and you hurt the rest of the system.

Cutting costs while maintaining service is no easier. Take a look at the cost structure of Delta Air Lines, shown in the written copy of my remarks:

Twelve months ended December 31, 1990

Salaries and related costs	40%
Fuel	17
Travel agency commissions	9
Rentals and landing fees	8
Depreciation and amortization	5
Passenger service	4
Aircraft maintenance	3
Other	12

Note: Percentage figures do not add up to 100% due to rounding

Salaries are the largest item and the one most subject to direct control. However, pay cuts or layoffs undermine morale, service, and reputation. Nevertheless, controlling labor costs is a necessity, both now and over the long term. Unfortunately, some airlines face very difficult labor negotiations and wide disagreement remains as to suitable levels of compensation in the current environment.

What does the current crisis imply for the future? First, we are likely to see further airline bankruptcies and further consolidation. Eastern is already auctioning off its assets. If the war and recession persist for even a few months, Pan Am's chances of reorganizing will be seriously undermined. TWA, already in default on some debt, is under severe financial pressure, as well. Continental, operating in Chapter 11, still has a fairly good chance of reorganizing successfully, but is being seriously hurt by the adverse environment.

It is very important to recognize that the present crisis did not create the problems faced by Eastern, Pan Am, and TWA; it only worsened them. These are very weak airlines and have been for some time. In the case of airlines with basically healthy operations but heavy debt loads, Chapter 11 can and probably will allow a successful reorganization. Therefore, I do not expect to see the industry consolidating into only three or four giant airlines.

A second important effect of the current crisis will be to erode further already weakened airline balance sheets. This is of concern because it affects all airlines, even the strongest, and may permanently damage their ability to raise capital. The industry is highly leveraged and becoming more so. Exhibit I to my remarks shows debt as a percentage of capital, adjusted for off-balance sheet leases, of Delta, American, and United. Their leverage is far above that of a broad index of industrial companies, even though the late 1980's were a period of relative prosperity for airlines. When yearend 1990 data is available, the disparity will be even worse. The underlying causes are the immense cost of new equipment, and a tax code that encourages debt and leasing.

The fact is that U.S. airlines cannot fund the expenditures needed to grow, improve fuel efficiency, and meet federally mandated noise requirements unless they earn higher returns. Sale of common stock is difficult, although one airline--American--has done so recently. Easing restrictions on foreign ownership will help some, but the amounts involved are not really that great. In any case, foreign airlines will not put up money without the prospect of either adequate returns or some measure of control over the U.S. company.

Debt and leases, which provide the great majority of outside funding, are becoming more expensive. This reflects both concerns about airline creditworthiness and problems in the credit markets themselves. Unsecured debt is more expensive for strong carriers and has evaporated completely for weak ones. Finance leases, the largest single source of funding, are also becoming costlier. Equity investors in leveraged leases have a reduced appetite for tax deductions, Japanese financial institutions are cutting back on overseas investment, and the value of aircraft--the collateral in secured debt--has weakened.

There is some good news amidst the gloom: airline industry profits will recover by 1992 or 1993. The war will not last forever--hopefully not much longer at all. The economy will recover, albeit slowly. And fuel prices will decline, a process which has already begun. The large losses reported by Eastern will no longer be included in the industry totals.

My concern is that this recovery will be misinterpreted. We need to consider two key factors when that time comes. First, keep in mind the industry's net profit margin. The average for manufacturing companies is 3-6%, depending on where you are in the business cycle. Airlines earned a cumulative average of less than 1% during the 1980's, with the peak only 2.6% in 1988. Second, consider how much the industry is spending on new planes and facilities, a sum which will likely be many times their earnings.

A recovery in airline profits will also raise the entirely legitimate question of whether consolidation has undermined competition. To begin with, profits are not the proper measure of this issue, airline yields are. Second, as I have noted earlier, airlines desperately need to earn better returns if they are to fund capital expenditures, so some rise in ticket prices is actually desirable.

Even so, I don't think you will see a large increase in overall yields. There are too many factors inherent in this business which will prevent that. First, there will be several major airlines with national route networks competing in all major markets. Second, discounts will be needed to attract vacation travelers, who are price sensitive.

Lastly, the product offered, a seat on a particular flight, is perishable. Once the flight leaves, it's gone forever. Furthermore, the cost of serving that last passenger on board a particular flight is minimal. That creates a tremendous temptation to find some way to lure more passengers on board through low fares, frequent flyer miles, toaster ovens, or whatever.

There is a competitive problem which worries me, but it's not the disappearance of several weak airlines. Consider the Northeast Corridor, the Washington to New England market. We have two air Shuttles, one owned by a bankrupt airline, the other owned by a nearly bankrupt real estate developer. And yet, ticket prices on those Shuttles are over $100 for a short hop trip. The major reasons are limited available slots and gates, terrible air traffic congestion, and high labor and other ground costs. In short, it is difficult and costly to operate there.

The real danger to competition is inadequate infrastructure. Planes can be moved around; gates and runways cannot. Re-regulation will not solve this problem. Indeed, the half of the air transportation system which is still regulated--airports and air traffic control--is where the bottleneck lies. Likewise, the worst cases of uncompetitive pricing occur on international routes, where capacity is limited by bilateral treaties.

Therefore, Standard & Poor's believes that the policies which will most effectively ensure both healthy competition and healthy airlines are the following:

1) Increase investment in infrastructure supporting air transportation. This is a matter of economic development and international competitiveness, not just convenience.

2) Allow airlines to earn sufficient returns to support growth and modernization. Again, this is increasingly a matter of developing world class competitors in a global market. It is not inconsistent with proper antitrust policies and promoting competition. The United States is a big enough market to support many vigorous competitors.

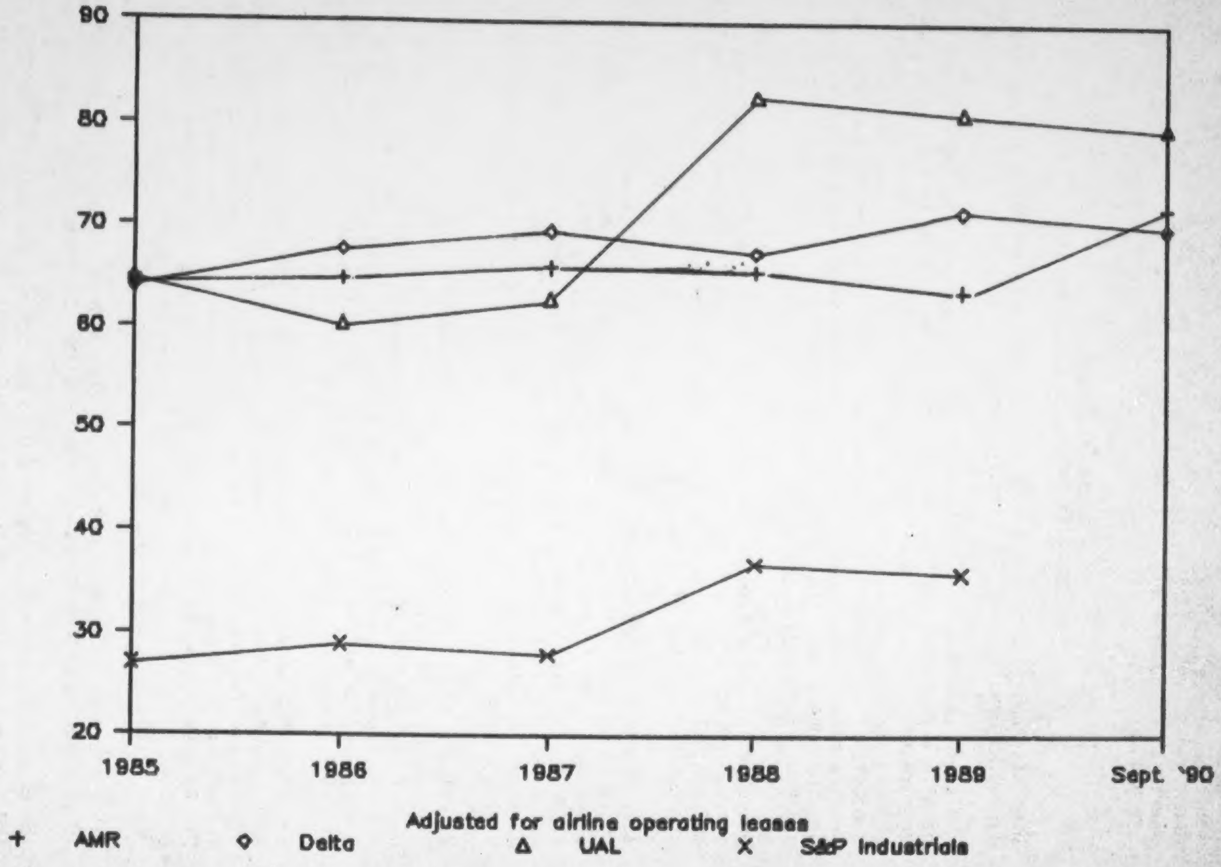
3) Develop a framework which allows good labor relations and reasonable labor costs, as some airlines have already. This is not a utility which can pass on added costs to the consumer, but a service business facing tough competition and costly investment.

4) Continue to push for greater liberalization in international air transportation. This can include cabotage at some point in the future if the new opportunities granted are equivalent for both parties.

None of this is revolutionary and most of it is probably not particularly controversial. However, stating it is one thing. Implementing it is another. That is the challenge.

Thank you for your attention.

Debt as a Percentage of Capital



Adjusted for airline operating leases

Helane Becker
Lehman Brothers
200 Vesey Street - 14th Floor
New York, NY 10285-1400
212-298-3386

Issues for Hearing on Financial Condition of Airline Industry

Good afternoon ladies and gentlemen. We are here today to discuss the financial condition of the airline industry.

The financial condition of the industry is pitiful. The industry has been in a recession for the last six quarters. We believe it will remain in a recession for at least the next two quarters. In line with this, we believe the U.S. industry lost $1.5-2.0 billion in the 1990 fourth quarter. This followed five prior quarters of consistently bad year to year earnings comparisons. The last positive year over year comparison was the 2Q89 versus the 2Q88. The next positive comparison we expect is the 3Q91, compared to the 3Q90.

We estimate that following the record 4Q90 loss, the 1Q91 loss should narrow to $700 million. In the 2Q91, we estimate a smaller loss, to $300 million. The first profit in 1991 should be the 3Q91. And, of course, the 4Q91 comparison will be easy.

1992 should be a better year, although we expect the peak in the current cycle to be 1993. The airline industry manages to consistently price below cost. We do not believe there is anything on the horizon to suggest this will change. There are two differences that we expect will occur in 1992 that were not there in 1990 or 1991. One is lower fuel cost and the other is an improving economy. These are the two reasons 1992 earnings will be better next year.

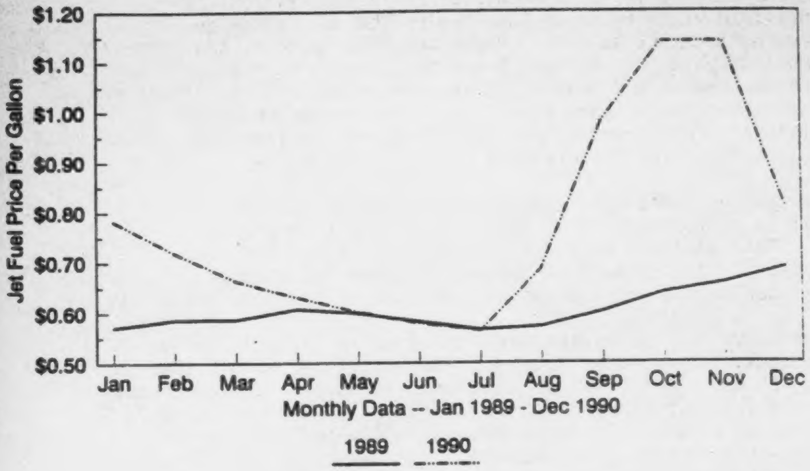
We believe there are a number of airline companies that will continue to sell assets. If they don't, they will fail. There are two airlines operating in bankruptcy. This is unprecedented. Even though three airline companies were operating in Chapter 11. Eastern is liquidating. I suspect that of the two left, Pan Am and Continental, Continental has the best chance of flying out of bankruptcy.

We expect Pan Am will also be liquidated. With the Persian Gulf war, many business travelers have cancelled trips offshore. The cancellations are especially pronounced in Europe. Unless Pan Am can generate revenue faster than it spends money, it will be liquidated. (Neither Eastern nor Pan Am have planes on order. Continental Holdings has over 100 aircraft on order that were going to be split between Continental and Eastern. Now, those planes are destined for Continental only.)

Other airlines we worry about include TWA, Midway, Hawaiian, Aloha, and to a lesser extent, Northwest, USAir and America West.

The primary reason the industry did so poorly was the cost of jet fuel. The U.S. airline industry currently utilizes 16 billion gallons of jet fuel annually. This implies every penny change in the price of jet fuel is equivalent to $160 million annually for the industry. In the fourth quarter, the average price of jet fuel was $1.10 per gallon. This was up from an average price of $0.57 in the third quarter. The industry's annual fuel bill increased $8.5 billion.

Chart 1
Jet Fuel Price Comparisons



There is absolutely no way the industry can raise fares enough to cover this increase. And of greater concern is the fact that the price of oil, and jet fuel, has not stabilized. The price of jet fuel right now is a little out of kilter with the rest of the oil products because a significant portion of the world's refining capacity is in the Middle East, and a large portion is being kept there to support the military operations. The government, if it chooses, could subsidize the fuel cost for airlines, but this is too much government involvement.

A second reason the industry did so poorly last year was the weak economy. No matter what anyone says, airlines are cyclical. If the economy turns down, traffic turns down. Furthermore, many companies have cut travel budgets, implying continued weak traffic.

Already, jet fuel is down to $0.70 per gallon the the spot market. This is $0.40 below the average cost for the fourth quarter. It also translates into an annual savings of $6.4 billion for the industry. We expect jet fuel to average $0.75 per gallon this year, and $0.70 per gallon in 1992. Clearly, these numbers are highly volatile, and subject to change.

The economy, however, will continue to be a major problem. At Lehman Brothers, we believe GNP will decline 0.8% in 1991. This compares to an increase of 0.9% in 1990, so traffic is expected to remain under pressure. For 1992, our preliminary GNP estimate is an increase of 3.7%. This suggests the industry will recover somewhat next year. The pain is expected to be great in 1991. We think of 490,000 airline industry employees, 40,000 will lose their jobs. Industry employment is already down 10,000 people, from 500,000 at the end of 1989. In the next cycle, we think 1993 will be the peak in earnings.

We believe in the market place solution to the industry's problems. Fewer airline companies does not mean a decline in competition. When a traveler in Hartford wants to go to Los Angeles, he/she cannot go nonstop. A connection must be made. Right now, the traveler can connect in Atlanta, Philadelphia, Pittsburgh, Detroit, Chicago, Nashville, Dallas, St. Louis, Newark and Denver. There are probably other cities we left out. This is not an oligopoly business. Connecting complexes ensure competition. Furthermore, fewer U.S. airlines will be much tougher competitors for foreign airlines.

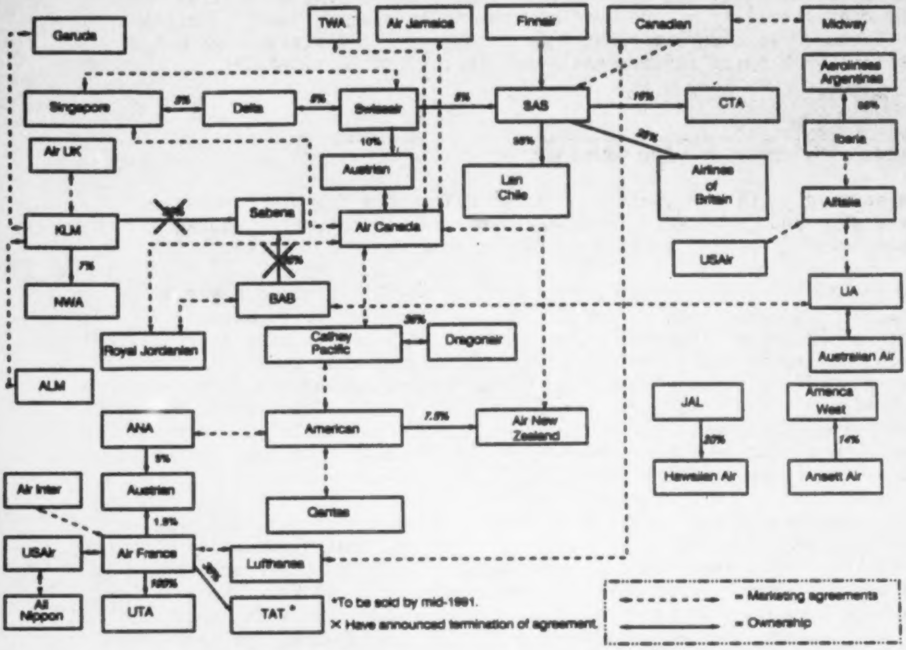
We are of the opinion there will always be discount fares available to travelers. It is up to the airline industry to manage revenue on board the aircraft. This suggests a mix of low fare paying and high fare paying passengers. It also means increased focus on belly cargo. Discounts will continue to be a major pricing tool of the industry.

As we mentioned earlier, the market place solution is the only answer to ensuring a vibrant, competitive industry. The government should stay out of regulating the air transportation industry. It should, instead focus on de-regulating the airport system. Airports are already overcrowded. This is a perennial problem of growth. There is limited airside and landside access to airports. The industry, together with the FAA, the Department of Transportation (DOT) and local communities, will need to address this issue quickly.

Foreign Ownership

This has been a trend since 1987. As shown in Chart 2, airline companies, worldwide, have aggressively pursued each other.

Chart 2
Marketing and Cross-Ownership Agreements


Garuda
TWA
Air Jamaica
Finnair
Canadian
Midway
Aerolineas Argentinas
Singapore
5%
Delta
5%
Swissair
5%
SAS
10%
CTA
85%
Iberia
Air UK
10%
Austrian
35%
Lan Chile
20%
Airlines of Britain
Alitalia
KLM
Sabena
Air Canada
USAir
7%
NWA
BAB
UA
Royal Jordanian
Cathay Pacific
35%
Dragonair
Australian Air
ALM
JAL
America West
ANA
American
7.5%
Air New Zealand
20%
14%
5%
Hawaiian Air
Ansett Air
Air Inter
Austrian
1.5%
Qantas
USAir
Air France
Lufthansa
100%
All Nippon
UTA
TAT *
= Marketing agreements
= Ownership

*To be sold by mid-1991.

× Have announced termination of agreement.

We have thought the foreign ownership issue, including cross-border mergers would accelerate in the 1990s. We continue to believe this to be true.

The pressure to raise the foreign ownership limitations comes from the weaker U.S. airlines. We believe access to capital is a key issue to survival in the 1990s. Funding a capital spending program currently estimated at $160 billion is a second major issue. In our opinion, access to capital will be one of the primary issues airlines face in the next couple of years.

Foreign capital is likely to have a deleterious effect on the U.S. industry. The weakest U.S. airlines will probably be first in line to sell equity to offshore investors. This will keep weak airlines in business longer than perhaps they should (stay in business). In the instance of KLM-Northwest, without KLM interest, Wings Holdings would not have been able to take Northwest private. Furthermore, ownership percentage doesn't count. Voting ownership counts, and the current plan would still keep it below 25%. At this juncture, it's almost a non-event; the key in the NW/KLM agreement is future service opportunities. If Northwest expands in a market KLM serves, will KLM object? This question should have an obvious answer.

In the last few years, corporations had excess cash flow. Some of them set up subsidiaries to do tax based financing. As corporate earnings come under pressure, there is less cash available for leveraged leasing. Furthermore, these non-traditional lenders are paying more attention to the credit quality of the airline seeking to borrow funds. The plane to be financed is also important. We think the 2,500 planes that do not meet Stage 2 noise requirements will be retired this decade.

Foreign Ownership; It's Not Cabotage

We want to point out there is a major difference between foreign ownership and cabotage. These are two separate issues. Cabotage is the ability of a foreign airline to fly between two U.S. cities.

We do not believe cabotage rights will be quickly granted. Worldwide, many U.S. airlines are having difficulty enforcing rules already granted in prior bilateral negotiations. Self-handling at international airports is, in fact, one of the biggest issues that U.S. airlines are having difficulty resolving. Just the week of January 14, 1991, the U.S. solved a six month airport access issue at Narita Airport (Tokyo) for UPS and United Airlines. We do not think the current administrators want to continue giving away U.S. route rights without getting some increased access to foreign markets.

There are two likely trials for increasing access to both U.S. and foreign markets. The first could be in the current bilateral negotiations between the U.S. and Canada. A second test could be in upcoming bilateral negotiations between the U.S. and Mexico. All three markets have been deregulated. The Canadian government is completely out of Air Canada. The Mexican government likewise reduced its investment in various government owned airlines. More importantly, it is encouraging foreign investment in any one of the 58 government run airports. This is a step further than the U.S. has gone. In Toronto, a foreign firm handled the expansion of the international airport, so Canada is there as well. The North American market could well be the first trial.

Moreover, the DOT should continue to permit weak airlines to sell operating certificates for international routes. International routes should be flown by companies that can maximize U.S. market share. Chicago-London, for example, is far more valuable to American then it could ever be to TWA. American has more daily departures from O'Hare than TWA. There is no comparison. Similar comparisons can be made for United; Delta and others form their hubs to offshore destinations. The weak airlines, in selling their routes are also able to utilize the money to restructure their operations in an effort to survive. It probably won't always work, but if one airline can be saved this way, it would be worth it, if only to the employees of that airline.

Bermuda II

There is obviously a change in the wings with the pending sales of Pan Am's London route system to United, and TWA's to American. The bilateral agreement between the U.S. and the U.K., referred to as Bermuda II, is being discussed. The agreement allows only TWA, Pan Am, British Airways, or their corporate successors to fly into and out of Heathrow.

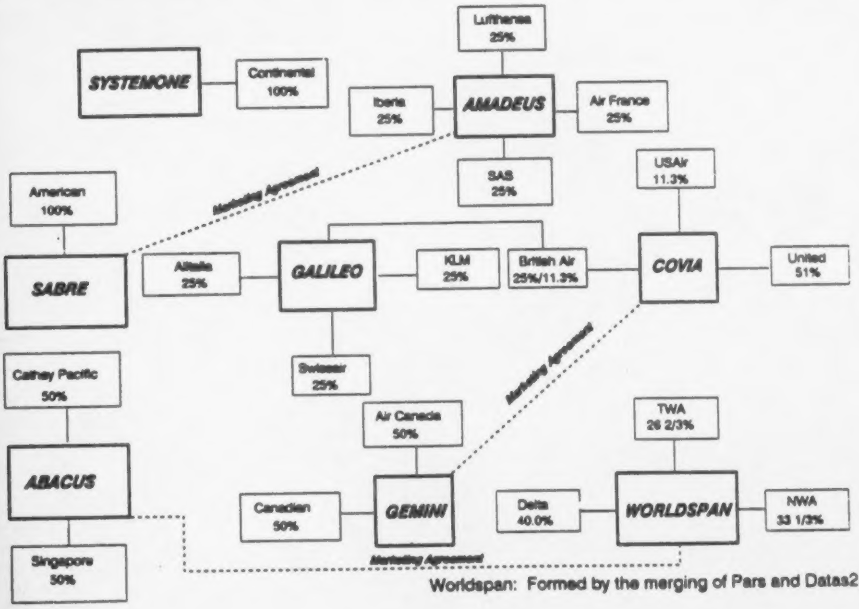
U.S. and U.K. negotiators are meeting to define corporate successor. American and United believe they are the successors to TWA and Pan Am. We agree with American and United, but we also think British Airways will gain increased access to the U.S. market in return for Heathrow access for AMR and UAL.

We think the UAL/PA transaction will be approved by the U.K. in February. The AMR/TWA transaction has not even been approved by the U.S. regulatory authorities.

Control of the Computer Reservation Systems

This is still a critical element of traffic growth. We think that on a worldwide basis, this industry will consolidate. Worldwide, we believe the computer systems will merge.

Consolidation Phase II


Lufthansa 25%
SYSTEMONE
Continental 100%
Iberia 25%
AMADEUS
Air France 25%
SAS 25%
USAir 11.3%
American 100%
Marketing Agreement
SABRE
Alitalia 25%
GALILEO
KLM 25%
British Air 25%/11.3%
COVIA
United 51%
Swissair 25%
Marketing Agreement
Cathay Pacific 50%
ABACUS
Air Canada 50%
TWA 26 2/3%
Canadian 50%
GEMINI
Delta 40.0%
WORLDSPAN
NWA 33 1/3%
Singapore 50%
Marketing Agreement

Worldspan: Formed by the merging of Pars and Datas2.

It's only a matter of time before there are three or four systems, down from the current eight (large ones). There are a host of company specific systems, such as Inlcom (JAL) and Travicom (BAB) that will probably merge into the large consortiums.

Finally, we would take this opportunity to reiterate our belief that the government should stay out of the airline industry. Regulation didn't work in the 1940-78 period. It won't work in the 1990s. Furthermore, let's remember that Congress originally de-regulated for lower fares and improved service. We can't possibly think that re-regulation will achieve the same results. I repeat: Stay out of this industry. Let the market decide. The market place solution is the right answer to this industry.

TESTIMONY OF
VICTORIA L. FRANKOVICH
PRESIDENT OF THE
INDEPENDENT FEDERATION OF FLIGHT ATTENDANTS
BEFORE
THE SUBCOMMITTEE ON AVIATION
HEARING ON
THE FINANCIAL CONDITION OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

Independent Federation of
Flight Attendants
603 Third Avenue, 5th Floor
New York, NY 10017
Telephone: 212-818-1130

Mr. Chairman and Members of the Subcommittee:

My name is Victoria Frankovich and I am President of the Independent Federation of Flight Attendants, representing TWA employees. We welcome this opportunity to discuss several alarming trends which are emerging in the United States airline industry. Let me emphasize at the outset that TWA employees have an interest in the continuing viability of TWA. Our concerns about maintaining competitive airline services mirror those of the traveling public and the communities served by TWA.

TWA can survive, but not under the current Department of Transportation policy of rubber-stamping route transfers. The DOT has adopted a view that the Government should not interfere with the decisions of airline management. IFFA strongly believes that the public interest, which DOT is responsible for protecting, includes the interest of corporate stakeholders -- the communities served by an airline, the traveling public, who will face higher fares and less services, and the employees who have devoted their lifetimes to the major airlines that are now threatened with extinction.

The airline industry today is divided into the "haves" and the "have nots." Acquisition of profitable limited entry international routes by the largest carriers could shortly eliminate airlines that are selling routes, and diminish the economic viability of those carriers that could not compete in the bidding war. Many are likely to first sell their assets and then, inevitably, fail. This dim prognosis is not likely to change in the short term, unless the Department of Transportation adopts a comprehensive regulatory policy to deal with the fundamental causes of the industry's financial difficulties.

The problem in the airline industry today is leverage, not labor. Recent attempts to make labor unions the scapegoat for the rapid consolidation of the U.S. airline industry do not comport with reality. The highest paid employees are those of the financially-strongest U.S. carriers. Moreover, the labor costs of the U.S. airlines are lower than those of European and Canadian carriers.

At TWA, employees enabled Mr. Icahn to acquire the airline, and the airline was able to post impressive operating profits because TWA employees' wages are among the lowest in the industry. TWA employees have "paid" to make TWA competitive with other airlines. But the benefits of this bargain have not been realized. The leveraged buy-out of TWA by the Icahn Group in 1988 ensured that the operating profit generated by airline operations would be wiped out by the massive amounts of debt the airline was forced to assume. At the time, TWA employees expressed their concern that the leveraged buyout was a pretext to begin the systematic liquidation of TWA's operations through route sales which were routinely being approved by the Department of Transportation. Unfortunately, subsequent events have proven that these fears were well founded.

The Department of Transportation recently approved the sale of TWA's Chicago - London route to American Airlines. Far more troublesome is the pending application to sell TWA's remaining

London route authority, Chicago gates, and other transatlantic routes. At TWA, and potentially as well as at other financially-stressed airlines, the assets and routes that are being sold are the ones that contribute the airline profits that are needed to service the airline's debt. Sales of vital international routes and valuable airline assets do not allow airlines to survive. With fixed debt and diminished revenues, operating losses will mount. At most, asset sales postpone the day of reckoning, if the fundamental problems are not resolved. Unless the Department of Transportation deals with the root causes of the industry's financial difficulties, it is likely to pursue policies which will eradicate the consumer benefits which the DOT claims have resulted from vigorous competition under airline deregulation.

In unregulated industries, management has no government licenses to sell off to generate cash to service debt. These companies and their lenders are motivated to reorganize operations, restructure debt, sell the company as a going concern, or if all else fails, seek the protection of bankruptcy courts to redress their financial difficulties. Efforts at corporate restructuring can be successful if the company maintains its productive assets.

Despite the deregulation rhetoric, the route transfer policies enunciated by DOT constitute a form of special regulatory largess by which private concerns are permitted to sell government-created assets. The result is contrary to the stated aims of the Airline Deregulation Act. The most valuable assets will always go to the highest bidder, which is also invariably one of the largest airlines. This contributes to the trend toward unacceptable industry concentration. DOT regulatory policy also discourages changes in ownership or defers corporate restructuring until it is too late, and liquidation is the only answer.

IFFA does not mean to suggest that all route transfers should be forbidden. The problem is that the DOT decisionmaking process governing sales of international routes appears motivated by panic, not reflection. The mere threat of bankruptcy seems to be a sufficient grounds to secure what is in effect an exemption from the public interest review that the Department of Transportation is required to perform under the Federal Aviation Act.

Congress has instructed the DOT to promote airline competition in all its regulatory functions.[1/] Yet, when reviewing route transfer applications, the DOT concludes that the desires of carrier management always outweigh the interest of communities, the traveling public, and airline employees. It is perhaps reasonable to suppose that airline managers would make better decisions about what markets to serve and prices to charge than regulatory agencies. However, professional airline managers would not choose to cannibalize their most valuable operating assets but for financial pressures that have been created by inordinant amounts of debt. The DOT's decision not to consider seriously the financial

---

1/ How is it that the Department will decline to grant new route authority to an airline in a carrier selection case because the public interest would be better served by promoting airline competition, yet the disappointed applicant can turn around the next day and buy that same route, and the DOT will then decline to assess the effects on airline competition?

condition of airlines either as part of an ongoing fitness obligation or in the context of a route transfer case has led to a situation in which airlines will come under increasing pressure to sell government licenses, leaseholds at congested airports, or slots at controlled airports, whenever there is an economic downturn.

While no one can deny that the Persian Gulf crisis has contributed to the financial woes of certain airlines, it does not follow that sale of international routes is the answer. Route sales should be the last response to financial pressures after other sources of equity and debt have been exhausted. At TWA, route sales are the first response.

In 1988, TWA employees warned that the leveraged buy-out of TWA to bring it under the private control of Carl Icahn, left the airline vulnerable to recession and fuel price increases, both of which are commonplace in the airline industry. It is unclear the extent to which the resultant debt and other intra-corporate transactions involving the Icahn group may be contributing to the claimed financial problems of TWA. We do know that in April, 1990, TWA filed an exhibit in a route proceeding claiming to have $1.159 billion in cash and liquid assets. More recently, in sworn testimony, Chief Operating Officer William Hoar stated that TWA had plenty of cash. We do not dispute TWA is losing some money, today. However, TWA employees fully appreciate that, with the sale of TWA's vital transatlantic authorities, TWA cannot make money in the future.

Are TWA's long-term prospects as an airline being sacrificed to protect Carl Icahn's cash and position in USX stock? What assurance is there that, having once realized the value of TWA's international routes through route sales, Carl Icahn will not simply liquidate the airline? Have TWA assets been sold to other Icahn controlled companies, and, if so, on what terms?[2/] To date, the DOT has erroneously declined to address these questions by dismissing the serious issues which they raise with the perfunctory claim that the DOT need not involve itself in labor-management disputes. But DOT has chosen sides by deferring to carrier management instead of performing an independent, factually oriented analysis of the public interest. It is not too late for TWA, but it soon will be if DOT hastily approves the transfer of TWA's vital transatlantic route authorities and assets at various U.S. airports.

The trend toward liquidation of U.S. airlines is likely to continue and accelerate because sale of vital assets will necessarily diminish an air carrier's long-term viability, in the absence of an alternative plan of airline operations. If it is unable or unwilling to resolve these issues, the Department should decline to approve a route sale, thus preserving for a bankruptcy

---

2/ These are the sorts of issues which are entertained by bankruptcy courts. For example, the Trustee for Eastern Airlines was able to secure a settlement concerning claims of impermissible intracorporate transactions, but the damage had already been done and Eastern Airlines had by that time ceased to be a viable airline competitor.

court maximum flexibility to reorganize the airline, and address issues concerning the propriety of corporate transactions.

The Independent Federation of Flight Attendants approaches the issues of foreign ownership and cabotage with caution. A larger degree of foreign ownership may permit a U.S. airline to continue operating with U.S. employees under economic and safety regulations that pertain to U.S. flag carriers. This seems to be a more satisfactory solution to current financial difficulties of some airlines than losing both U.S. airlines and U.S. jobs.

Continued consolidation in the U.S. airline industry will inevitably have adverse economic effects on cities that had once enjoyed the benefits of airline deregulation. Hub airports, such as St. Louis, currently enjoy levels of service that would be lost if TWA is allowed to be liquidated. These cities can look to become mere spokes to another carrier's hub if the trend toward consolidation continues unabated. The loss of airline jobs will also affect the local economies as the number of airline competitors contracts. IFFA is concerned that loss of airline services and increases in price will lead cities and airline passengers to demand expanded access of foreign carriers to domestic U.S. markets. This is no solution to a problem that can be avoided by preventing the further erosion of the U.S. airline industry.

The Committee has asked whether there should be any re-regulation of airline service or rates. Implicit in this question is the assumption that increased concentration in the airline industry will require remedial legislation. As long as the DOT is sufficiently mindful of its responsibility to promote competition in discharging its current regulatory functions, IFFA believes it will not be necessary to reach this question.

Congress recently amended Section 401(h) of the Federal Aviation Act to impress upon the DOT its obligation to carefully consider the long-term competitive implications of its decision to approve route transfers. IFFA, as well as a number of civic and labor parties, has submitted extensive comments to the DOT establishing that the proposed transfer of TWA's transatlantic operations and Chicago facilities will inevitably result in its elimination as a U.S. airline. Given Mr. Skinner's reaffirmation of the DOT's commitment to preserving airline competition, we are hopeful that DOT will carefully consider the application of these standards to the joint application of American Airlines and TWA, in which case it will be denied.

However, DOT's discussion of the requirements of this new legislation in the context of several recent cases causes IFFA to question whether the DOT intends to implement Congressional directives to consider the effects of route transfers on the domestic U.S. airline industry, the viability of each carrier party to the transaction, and the competitiveness of the U.S. airline industry in foreign markets. Congress may wish to consider further legislation to insure compliance with the spirit of the new law.

If DOT adopts policies that do not maintain the competitive viability of the airline with which an employee is currently serving, then IFFA believes that some form of relief must be fashioned to avoid undue hardship to the employees of the failed airlines. The promises made to airline employees in connection with airline deregulation have not been kept. At a minimum, employees should enjoy the right of first-hire, which had been part of the Airline Deregulation Act.

A more equitable requirement would be to insure that the people who are performing a function today go with the jobs that are being transferred. TWA flight attendants are highly skilled and experienced personnel. Despite years of loyal service, they enjoy no preference in hiring at American Airlines and will lose wage seniority and certain pension benefits.

The DOT has steadfastly refused to impose the so-called standard Allegheny-Mohawk labor protective provisions for close to a decade. During this time, Congress has attempted to legislate these benefits on a number of occasions, without success. IFFA urges the Subcommittee to consider enacting limited job preservation legislation that would provide the first right of hire to employees who had served on routes to be transferred. These employees should be permitted to retain their seniority for purposes of bidding on routes, to maintain their existing level of wages, and to credit their years of service toward vesting in the acquiring company's pension plan. Since the airlines selling routes have all secured wage concessions from their employees, the employees transferring with the routes would in all likelihood be "less costly" than similarly experienced flight attendants in the acquiring carrier.

Let me emphasize again that IFFA's primary objective is the preservation of TWA as a viable airline competitor. We are troubled that the DOT is no more sympathetic to "airline competition protection" than it is to labor protection. In that event, not only TWA employees but also a number of communities and airline passengers will suffer economic injury from the resulting decline in airline competition.

Mr. Chairman, the employees of TWA thank you for this opportunity to testify on issues which will determine TWA's fate, and the future of TWA employees. We are gratified that you share some of our concerns about the direction of DOT policy.

STATEMENT OF
JAMES E. LANDRY
SENIOR VICE PRESIDENT AND GENERAL COUNSEL OF THE AIR TRANSPORT ASSOCIATION OF AMERICA
CONCERNING THE FINANCIAL OUTLOOK OF THE AIRLINE INDUSTRY
BEFORE THE SUBCOMMITTEE ON AVIATION
COMMITTEE ON PUBLIC WORKS AND TRANSPORTATION
U.S. HOUSE OF REPRESENTATIVES
FEBRUARY 6, 1991

The Air Transport Association of America appreciates this opportunity to explore the financial outlook of the U.S. airline industry and, we earnestly hope, to begin to chart the appropriate course of the U.S. Government's aviation policy for the 1990s.

ATA is the trade and service association of the U.S. airline industry. We have 20 U.S. members and two Canadian associate members. Our members collectively account for over 96 percent of the revenue passenger miles that scheduled airlines operate in this country, and roughly the same percentage of the industry's freight traffic.

These are excruciating times for the airline industry. The financial performance of the airline industry in 1990 was the worst in its history. Although financial results for the year are incomplete, we may exceed $2 billion in net losses for 1990. With the outbreak of hostilities in the Persian Gulf, we expect continued losses through 1991. Indicative of the financial pressures facing the industry is the cessation less than three weeks ago of scheduled operations of Eastern Air Lines, a carrie which for over six decades served the travelling and shipping public. The plight of the 18,000 employees of Eastern underscores the very real suffering of our industry today. In addition, two other major carriers are operating under Chapter 11 of the Bankruptcy Code.

Despite the greatest annual financial loss in the history of the airline industry, a declining economy, volatile fuel prices, and national, state and local governments' repeated imposition of taxes and fees on commercial air travel, U.S. airlines continue to offer passengers and shippers an unequalled array of price and service options. We remain confident that our industry can continue to serve the public with a full spectrum of choices.

We have one simple request today. We ask that in the 1990s the Federal Government do what it promised but failed to do in the 1980s: meet its aviation-related responsibilities. This means that the Federal Government must fulfill its unique obligation of assuring the development of needed airspace capacity, and avoid legislative or regulatory actions that could interfere with the benefits that deregulation has brought to airline consumers.

Our industry accounts for over three percent of America's gross national product, making an annual contribution of some $185 billion to our nation's growth. The airline industry has become the primary mode of intercity public transportation and, as such, makes an indispensable economic contribution to the nation. Hence, when, as in the 1980s, the Federal Government avoids meeting its obligation to promote aviation infrastructure improvements, the nation bears the burden of that inaction.

I

These are trying times for the airline industry. This statement will describe the financial distress that we are suffering today. At the outset, however, I wish to summarize the benefits that airline deregulation has brought to consumers.

Deregulation has transformed the domestic airline industry. Airlines today are far more efficient and competitive than they were in 1978 when the Airline Deregulation Act was enacted. The result is that passengers and shippers have a variety of air transportation opportunities that would have been unimaginable in the 1970s.

Despite such indisputable improvements, which all credible studies have verified, critics continue to challenge airline deregulation. In so doing, they seem to us to be nibbling at the edges of the matter rather than acknowledging its central reality: the airline consumer is today far better off than he or she was before Congress unfettered the airline industry from the chains of governmental economic regulation.

Our September 21, 1989 testimony before the Subcommittee described at great length the benefits that airline consumers have realized from deregulation. We do not wish to repeat that testimony. Nevertheless, several important changes in the industry since 1978 that have greatly benefitted the consumer should be kept in mind:

- Airline consumers have annually realized $10 billion in service and fare benefits because of deregulation, according to a study published by the Brookings Institution.
- Average revenue per passenger mile, which is a reflection of our prices -- commonly referred to as "yield" -- has declined 23 percent in real terms.
- Scheduled daily departures have increased over 40 percent.
- The proportion of passengers travelling in markets served by three or more carriers was 54.7 percent in 1988. This represented 248.7 million passengers. It was 183 million more passengers than in 1978, when the proportion of such passengers was only 23.8 percent.
- Small- and medium-size communities experienced significant expansions in service, a phenomenon attributable in large measure to the growth of hub-and-spoke operations.
- Seventy-four percent of the population has now flown,

an increase since 1978 of 11 percentage points or 35 million people.

These substantial improvements in consumer welfare are the products of competition, not governmental fiat. No regulatory agency could hope to achieve such results. We do not wish the economic adversity that the airline industry is suffering today to be seized upon by the critics of deregulation as an excuse for resurrecting governmental regulation of the airline industry. In the long run, both consumers and airlines will be best served by relying upon market forces to shape our industry.

II

A

The airline industry is currently experiencing unprecedented financial adversity. While we are hopeful that this situation will improve soon, near-term results for the industry are likely to continue to be unfavorable.

Our preliminary data for 1990, which reflect the results of major and national carriers and which are subject to revision, indicate that the industry grew moderately during the year but suffered from extraordinary increases in expenses.

Major and national carriers flew 464.4-million passengers in 1990, which was a 2.9 percent increase over the 451.2-million passengers carried in 1989. Revenue passenger miles for 1990 were 456 billion, while available seat miles were 730.8 billion. This resulted in a load factor for major and national carriers in 1990 of 62.4 percent, which was a 0.8 percentage point drop from the 63.2 percent load factor of 1989. Yield increased from 12.42 cents per revenue passenger mile in 1989 to 12.71 cents per mile in 1990. Total revenue for major and national carriers increased from $68.3 billion in 1989 to $74.9 billion in 1990.

Although revenues increased 9.7 percent between 1989 and 1990, expenses increased from $66.5 billion to $76.4 billion, which was a 14.9 percent change during the period. The chief culprit for expense increases outstripping revenue increases was the steep rise in jet fuel prices. Major and national carriers paid slightly more than $9.1 billion for fuel in 1989 and almost $12 billion for fuel in 1990. Some of this increase reflected expanded operations in 1990, but the bulk of it can be traced to the 24 percent rise in the average price of jet fuel, from 60.1 cents per gallon in 1989 to 74.8 cents per gallon in 1990. This latter figure obscures the fact that in October the spot market price of jet fuel had skyrocketed to $1.39 per gallon.

Employment among major and national carriers rose in 1990 to 513,268 employees from 481,881 employees in 1989. Since 1978, airline employment has grown by more than 205,000 employees. Regrettably, the recent economic downturn has resulted in our members laying off more than 13,000 of their employees, in addition to the Eastern workers who have lost their jobs.

B

Several significant factors have contributed to the poor financial results of the airline industry. They are the recession afflicting the U.S. economy and the consequent weakened travel demand; the extraordinary rise in jet fuel prices in the summer and fall of 1990, and the lag in their decline as crude oil prices have fallen; the repeated imposition and increases of taxes and governmental fees on air travel; mandated federal regulatory initiatives affecting commercial aviation; and the failure of the Federal Government to develop needed airspace capacity.

Economists may debate exactly which month the current recession began, but there is no doubt that for the airline industry it was in full force during the fourth quarter of 1990 and continues unabated today. Although complete results for the fourth quarter are not yet available, the airline industry's net losses for the quarter are expected to be approximately $1.7 billion. That is the largest quarterly loss in our industry's history.

Our industry's fourth quarter loss is attributable to two factors: the sagging U.S. economy and the inability of airlines to generate revenues to meet the sharp run-up in jet fuel prices that occurred during the summer and fall. The Commerce Department has reported that the gross national product contracted in the fourth quarter of 1990 at a 2.1 percent annual rate. This retrenchment of the economy resulted in stagnant demand for domestic air travel. At the same time, airlines were suffering from fuel costs that did not merely soar, but went ballistic. Between the first week of August and the second week of October the average spot market price of jet fuel rose from 63.5 cents per gallon to $1.39 per gallon. Thereafter, the average spot price began a decline that has been more leisurely than that increase.

Airlines were unable to recoup the higher costs of jet fuel that they bore from August through the end of 1990. Although widely publicized increases in unrestricted domestic coach fares, which averaged about 15 percent, occurred in late 1990, lagging demand and intense competition resulted in deep passenger fare discounts remaining widely available. Indicative of the robustness of discounting in our industry during the latter part of 1990 was the introduction and rapid spread of two-for-one fares. Ninety-two percent of domestic air trips in December were taken on discount fares. For the entire year, 91 percent of domestic air trips involved some form of discount; the average discount was 65 percent off the applicable full fare. Because of the pervasive discounting of fares, the airline industry experienced in the fourth quarter only anemic yield increases: six percent in both October and November, but less than three percent in December. We therefore ended the year with fuel price increases far outpacing revenue increases. The result was the airline industry's $2 billion loss -- the worst year financially in its history.

Our painful current experience should have one benefit. It should silence those critics who believe that the acquisitions and mergers that occurred in the airline industry during the second half of the 1980s produced an anticompetitive oligopoly. The intense discounting witnessed in 1990, especially in its fourth quarter, was indisputable evidence, not of the manipulation of oligopolists, but instead of the competitive responsiveness of rivals.

Such competitiveness should not have surprised any careful observer of our industry; it was the predictable continuation of a pattern firmly established in the 1980s. Although there were consolidations of airlines in the mid- and late-1980s, competition in the airline industry intensified through the decade. This reflects the repeatedly exhibited inclination of airlines to add service in existing markets and enter new markets. Hub-and-spoke systems provide them with the means to pursue such expansion. One underappreciated beneficiary of this expansion is the smaller community. Appendix 1 indicates that while large and medium cities registered impressive gains in service since 1978, smaller communities also enjoyed significant service improvements during that period.

Whether measured in terms of fares or service, our industry has consistently exhibited an intense competitiveness since its deregulation in 1978.

C

1

The airline industry and the government seem to be working at cross purposes. We suffer from the repeated imposition and increases of taxes and fees on various elements of air travel. The amount of federal tax on an airline ticket has increased 81 percent in the last ten years. Airline prices, unadjusted for inflation, have increased only 12 percent in that period. The aggregate effect of those exactions has been to make commercial air transportation appreciably more expensive, which further reduces demand for our services and thereby exacerbates our losses. Moreover, they negate our industry's efforts to stimulate traffic by lowering prices.

Congress last year increased the passenger ticket tax from eight percent to ten percent, the cargo waybill tax from five to 6¼ percent, and at the same time raised other aviation taxes. Unfortunately, those increases were not enacted to fund needed improvements to the aviation infrastructure. Instead, their primary purpose was to raise general revenues for the Treasury. Thus, air travel in the next five years will be burdened with $12 billion in added federal taxes. Experience reveals that competitive pressures will force airlines to absorb most of these tax increases rather than recouping them from consumers.

In addition, Congress last year authorized airports to levy passenger facility charges on passengers. PFCs are intended to fund on-airport improvements. They will make air travel more expensive. Depending on his or her itinerary, a passenger may be assessed a total of $12 in PFC charges. It is anticipated that PFCs will cost passengers approximately $1.2 billion annually.

We are hopeful that the revenues that PFCs generate will be applied to needed airport capacity enhancements. In this regard, we look forward to participating in the rulemaking proceeding that FAA is required to conduct under the PFC enabling legislation.

Nevertheless, PFCs will not be an unalloyed benefit to air travelers. They will not resolve environmental disputes that plague many airports, including some of the nation's largest facilities. Furthermore, even if significant expansions of airport capacity turn out to be the products of PFCs, such expansions will prove nugatory if they are not accompanied by meaningful improvements in the air traffic control system. In this regard, we wish to point out that the FAA's efforts to increase National Air Space capacity are five to eight years behind schedule.

2

The extraordinarily adverse financial climate that the industry labors in today would be alleviated if governmental regulatory activity more consistently reflected a realization of its effects on airline operations. We do not raise these matters to suggest that the Federal Government should forgo its aviation safety responsibilities. Rather, we do so because our industry's financial problems do not permit us to tolerate inefficiencies in the discharge of those responsibilities.

Our industry is complying with a series of ambitious federal regulatory initiatives. The most expensive of these undertakings is the retirement of stage 2 aircraft and their replacement with quieter stage 3 aircraft. U.S. airlines have committed more than $120 billion to replace older aircraft and expand their fleets. More than 250 jet aircraft are scheduled to be delivered to the airlines this year.

In addition, the FAA has initiated a series of safety enhancement programs that we support but which we conservatively estimate will over time cost the airline industry more than $10 billion. These programs include "aging" aircraft modifications; the introduction of "high-g" dynamic-load passenger seats in air carrier aircraft; security improvements; TCAS II; windshear detection; replacement of cabin materials with less flammable materials; cabin modifications for the handicapped; and drug testing. As this incomplete list suggests, our resources are being applied to a broad spectrum of safety enhancements, which typically are very expensive.

Operational matters under the control of the FAA also contribute to increased costs for the airline industry. Chief among these is air traffic control delays. ATC delays of 15 minutes or more decreased only 0.4 percent in 1990. On an average day last year, 1,075 such delays occurred. Delays frustrate the consumer and penalize the airlines enormously. We estimate that they increased annual industry costs by about $2 billion. One-third to one-half of those costs could be avoided if the ATC system received the improvements that have been promised for years.

We have previously expressed to the Subcommittee our belief that the performance of the ATC system demands immediate attention and substantial improvement. While we are repeatedly impressed by the dedication and professionalism of the staff of the FAA, we have been frustrated by the fact that although Congress informed the airline industry in 1978 that it would have to respond to market forces, that message was not translated into increased responsiveness in FAA funding or in its personnel and procurement policies. Consequently, air travellers and shippers suffer through chronic restrictions in ATC system capacity. Although we must respond to market forces, the Federal Government has chosen not to. The result is that for years travellers and shippers have been confronted with obviously inadequate ATC system capacity. No relief for the consumer is in sight.

We have done more than simply criticize the FAA for its delivery of ATC services. Over the years, we have suggested specific ways to improve the system. Most recently, the Aviation System Capacity Task Force, which ATA is a member of, submitted detailed proposals to the FAA to expand airport and airway system capacity through technological and procedural improvements. Those proposals are set forth in **Appendix 2**. Many of them would produce prompt improvements if adopted. Despite having submitted these proposals on September 25, the Task Force has not received a response to them from the FAA. We need your help in expediting action on these important recommendations.

The Federal Government must be much more responsive in fulfilling its aviation-related responsibilities. This means that with respect to the ATC system, we desperately require the capacity enhancements that were promised to system users in the 1980s but which remain unrealized. With respect to other regulatory activities, it means being certain that any contemplated agency action is required, and selecting the most efficacious option to achieve it.

Finally, just last week the U.S. Postal Service stopped shipping parcels weighing more than a specified amount on scheduled airlines. That decision will cost airlines millions of dollars annually.

3

Before closing, let us turn to some purely international matters, which are particularly critical to maintaining our competitiveness in the globalizing industry of the 1990s and beyond.

With respect to international aviation security, U.S. airlines continue to operate under tight, FAA-imposed security requirements that it refuses to apply to foreign-flag airlines. We are proud to provide air travellers, particularly those flying internationally, with consistently high levels of security. We seek no diminution in the ambitious security measures that we undertake daily. Nevertheless, in view of the fact that nearly one-half of U.S. citizens who travel by air internationally do so on foreign-flag airlines, it is incumbent upon the Federal Government to assure their safety. The way to fulfill that responsibility is through the application of the FAA's security measures to the operations of foreign-flag airlines serving the United States. For two years we have been frustrated by the unwillingness of DOT and the FAA to create a level playing field for aviation security. We thought that in the Aviation Security Improvement Act of 1990 Congress had directed the FAA to do just that. Unhappily, we have not seen a meaningful response to that direction. The persistent inequity in security requirements has contributed to the immense financial pressures on our members' international operations.

Moreover, we have witnessed a collapse of the idea that the federal inspection services are sovereign functions that benefit society at large and should be funded accordingly. The most recent departure from that principle, the creation of an agriculture inspection fee for international arrivals, is particularly eccentric: Congress imposed an undetermined fee, which it instructed the U.S. Department of Agriculture to formulate. (We expect the USDA to establish a fee of at least $3 per passenger.) That discretion is of concern to us for two reasons. First, it will cost passengers $120 million annually. Second, at that level, it presents the probability that the agricultural inspection fee will fund USDA services far beyond those that the international passenger uses.

The cost-efficient handling of international passengers is further frustrated by the policies of the federal inspection agencies, particularly those of the Immigration and Naturalization Service (INS). Several years ago the industry reluctantly accepted the concept of user fees to fund all INS airport operations; however, despite specific language in the fee provisions to the contrary, we continue to be charged for the detention of inadmissible passengers. The damage has been compounded by recent increases in INS administrative fines, even though carriers have shown an extraordinary ability to minimize abuses by visa violators. The combined effect of these policies alone costs carriers millions of dollars per year.

In addition, Congress for 1991 imposed upon airlines a fee of one dollar for each alien transported into the United States, for the benefit of the U.S. Travel and Tourism Administration. The amount of the fee could rise in subsequent years. This fee is unjustified and should be repealed. It burdens air travelers with the cost of sustaining a governmental promotional program that may benefit hotels, restaurants, and scores of tourist attractions but in all likelihood had no effect upon their decision to use air transportation to come to the United States.

Finally, the membership of ATA has reached tentative agreement that traditional restrictions upon the level of foreign ownership of U.S. airlines should be relaxed. We are currently formulating the details of our position about the full range of international issues, including foreign ownership.

4

We wish to bring one other topical issue to the Subcommittee's attention. War-risk insurance coverage is vital to U.S. airline operations. Commercial insurance coverage contains exceptions that are automatically invoked when certain kinds of hostilities occur. Airlines cannot operate if their insurance is suspended. Title XIII of the Federal Aviation Act authorizes the Secretary of Transportation to provide war-risk insurance coverage for the international operations of U.S. airlines. Unfortunately, that authority does not extend to the domestic operations of U.S. airlines. The war in the Persian Gulf has brought renewed attention to that gap. To assure the continuation of domestic operations, Congress must quickly amend title XIII of the Act to fill that gap and correct other practical shortcomings.

III

Imponderables cloud our ability to predict precisely what 1991 holds for the airline industry. We cannot forecast how events will unfold in the Persian Gulf or how our economy will respond to those events. However, we anticipate that this will be another challenging year for our industry, perhaps its most trying.

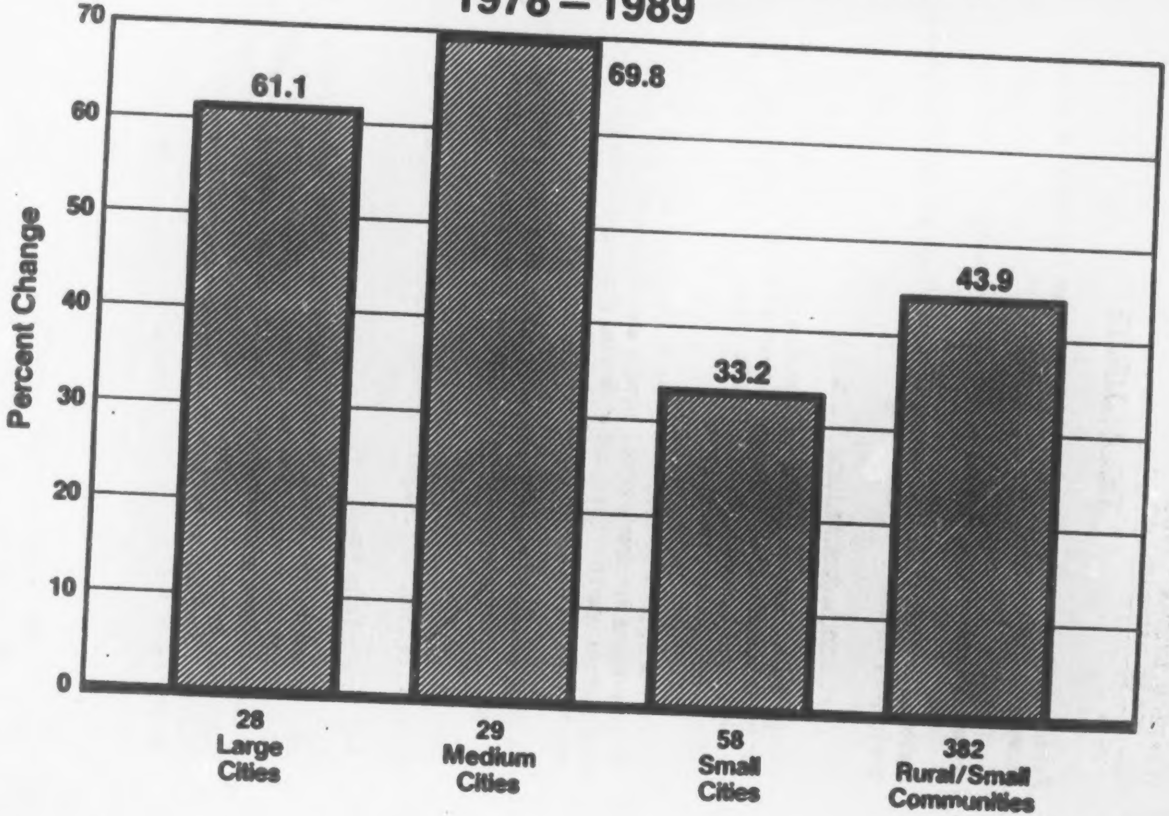
Airlines will continue to adjust to declining demand and higher costs. They will also compete vigorously, as they did in

1990, for the business of travellers and shippers.

The airline industry needs consistent, higher earnings to attract necessary capital. Throughout the 1980s, our industry took a series of steps, which were sometimes painful, to make its operations more efficient. However, we cannot continue to manage our costs without the commitment of the Federal Government to conduct its aviation policies in a far more disciplined and effective way than it has done in the past. Specifically, it must energetically enhance safety and capacity, and correct agency inefficiencies.

APPENDIX 1

GROWTH IN WEEKLY FLIGHTS
1978 – 1989



Source: DOT

APPENDIX 2

AVIATION SYSTEM CAPACITY TASK
FORCE RECOMMENDATIONS

THE PROJECTS

1. **Reduce required spacing for independent precision approaches to parallel runways.**

2. **Reduce minimums for operations to converging runways.**

3. **Establish procedures for IFR operations to closely-spaced parallel, triple and quadruple runways.**

◆ Near-term Actions for Items 1, 2 and 3

Complete development, installation, demonstration, procedure development and validation of high data rate and medium data rate sensor systems for closely-spaced independent and dependent parallel and converging runway reduced-minimums operations.

Expedite airspace procedure development, simulation, validation and demonstrations for closely-spaced parallel and triple/quadruple runway simultaneous operations, reduced-minimums converging operations, wet-runway reduced minimums operations.

Establish criteria and specific achievable minimums benefits from MLS or other navigation-based precision curved/segmented approaches and departures.

4. **Creation of additional computer capacity/memory for terminal operations.**

◆ Near Term Actions

As a highest priority, develop and implement additional capacity/memory for FAA's computer systems to permit terminal operations to be improved by use of available tools to aid controllers. Projects to increase needed system capacity should not be delayed to await the planned major FAA computer capacity increases. See also the policy recommendation concerning innovative data processing on Page 4.

5. **Introduce automation aids for controllers into terminal area operations to:**

   a. **achieve optimal arrival sequencing**
   b. **provide guidance for staggered and converging arrivals**
   c. **achieve minimum required wake vortex spacings**
   d. **reduce inter-arrival landing time variability by 50%**

FAA needs to reexamine and restructure its terminal automation effort to achieve first operational implementation on a fast track and without waiting for either full-system perfection or for the completion of development of large FAA computer/data processing systems. This would appear to be an especially appropriate application of the "outboard" data processing devices discussed above.

Because of the importance of gaining the airport capacity benefit of terminal automation to reduce inter-aircraft variability, and to achieve dynamic adaptation of necessary wake vortex spacings at an early date, these automation efforts should be pursued by themselves, and, while a part of a broader system scheme, should not be put in series with other efforts.

NASA has been working on a Descent Advisor/Sequence Planner, and the German Research Institute for Air and Space (DLR) has made major progress on their COMPAS system, as have the French with MAESTRO. NASA and DLR people have been working closely; FAA has also been involved. This work is advanced, and should be enthusiastically embraced by FAA to help make early progress, especially since these efforts have emphasized the importance of their advisory character, in which controllers are helped but remain fully involved in the control process.

FAA has engaged MIT Lincoln Laboratory to develop the TATCA project, which includes the clear responsibility to integrate the successful work of others who have been at work for many years on these topics, including earlier work for and by FAA and the MITRE Corporation.

◆ Near Term Actions

Development and validation of terminal automation tools should proceed for earliest possible stage by stage implementation of applications of "ghosting" (mirror imaging) applications, time-to-turn-to-final and final approach spacing advisory systems, dynamic wake vortex spacing adaptation, and a terminal operations planner.

Applications of "ghosting" to enroute and transition airspace merging traffic at feeder fixes should be considered for implementation at an early date.

Because a great deal of the promise of ATC automation depends on the successful introduction and use of digital air/ground communications, Recommendation 17 has special pertinence.

6. **Systematic and scientific analysis of enroute and terminal capacity needed.**

◆ Near Term Actions

FAA should immediately commission a systematic and scientific assessment of individual enroute sector and terminal capacity. The aim should be to streamline present enroute traffic flows utilizing heretofore unused capacity and form the basis for accommodating predicted increases in enroute demand.

Such analyses must include recommendations for resectoring, beneficial adjustments to enroute traffic flows, elimination or adjustment of mandatory preferential routes, and the elimination of many daily traffic restrictions. The use of parallel routes based on current flight management capabilities is one possibility.

ATC sector and area traffic flow and controller workload studies are needed to optimize sector design and to smooth operations in busy ATC sectors and areas.

7. **Early Completion and Transition to Initial Sector Suites Needed**

Expedite implementation of the initial sector suite subsystem at enroute and terminal facilities. Implementation at both of these facilities should take place simultaneously, or as nearly so as practical, with special emphasis on terminal area implementation.

8. **Develop requirements and procedures for use of cockpit traffic displays to provide better information to pilots on traffic situation and permit pilot participation in approaching VFR capacity in IFR conditions.**

Extensions of the TCAS technologies can be used to achieve greater ATC efficiency and capacity. Such extensions could lead to greater participation by pilots in a cooperative ATC process which involves a more effective level of shared responsibilities.

- Near Term Actions

FAA should undertake the development of procedures to exploit safely the use of such cockpit traffic displays and should undertake the development of minimum performance requirements for the aircraft systems to achieve most effective use of such displays.

Development of cooperative air traffic control procedures should be completed to coincide with the TCAS implementation.

FAA should identify any remaining issues which will promote optimum use of such technologies and to utilize the very extensive experience and expertise of NASA to bring the use of such displays to rapid and beneficial implementation.

For the longer term FAA should examine the potential of GPS/GNSS as a data source for cockpit traffic displays.

9. **Complete development/refinement of airspace and terminal area traffic flow analysis models and apply as appropriate to achieve more cooperative ATC.**

◆ Near to Mid-term Actions

Utilize the best available modeling tools to support airport-specific task force studies.

Adapt successful tools such as real-time Aircraft Situation Displays and dynamic models into mechanisms to dynamically adapt the ATC process in changing situations in cooperation with the airspace users. Explore possibilities of NASPAC technology to establish its proper application in this function.

10. **Continue and accelerate specific-airport capacity improvement studies and apply new technology concepts to establish their local application.**

◆ Near Term Actions

As traffic demand and flow patterns change and airports themselves change to cope with changing circumstances, an aggressive schedule of specific airport task force studies should be maintained by FAA and given the full measure of FAA resources to provide data and analyses of alternatives for airport and terminal area operations, and optimal connection to the enroute and transition system.

11. **Renew efforts to reduce operational impact of wake vortices.**

◆ Near Term Actions

a. Undertake an effort to gather wake signatures on all current aircraft, so as to minimize, by developing refined aircraft classifications, the need to use maximum spacings for lack of accurate data.

b. Undertake work to automate the use of wake vortex classifications and more refined aircraft data in displays and advisory systems (like early stage TATCA or the German COMPAS) so as to permit safe minimum separations to be established dynamically as part of early introduction of terminal automation.

c. Attempt to complete development of previously abandoned wake vortex detection and advisory system, adding the results of the work done by DLR (Germany) on turbulence detection, and tie the WVAS to other sensors to provide data further out on approach than WVAS alone can provide.

The system should be designed to meet ATC and operational needs for wake data at altitude, assurance of an adequate "green light" period, and an ATC operational doctrine.

d. Reemphasize the development of wake vortex sensing techniques in aircraft, along with the use of vision enhancement techniques and development of a control system response process to permit aircraft to sense and react to wakes, to permit them to close up on final when it is safe to do so.

e.. For the longer term there should be renewed efforts to eliminate wake vortices at the aircraft source.

12. **Expedite development of procedures for beneficial application of MLS or equivalent systems to achieve precision arrival and departure paths.**

♦ Near and Mid-term Actions

a. reduce operating minima commensurate with capability of MLS or equivalent capability

b. rapidly develop procedures for capacity enhancement by use of fully flexible approach, departure and missed approach paths, and development of least-noise arrival and departure paths

Gather actual current aircraft performance data near and on airports and during missed approach operations to permit use of realistic data in separation reduction studies (Use data from efforts 1, 2, & 3 as appropriate).

13. **Improve safe on-airport air traffic movement and control, which can improve capacity by permitting efficient use of runways, taxiways, holding areas and**

aprons in all significant weather conditions.

a. **by development of an automated, airspace system-compatible airport surface surveillance, guidance and control system which supports improved runway incursion control.**

◆ Near Term Actions

As a first step, implement the long-discussed runway incursion monitor using ASDE-3 enhancements tied in with appropriate ARTS-3 data.

◆ Near to Mid-Term Actions

Develop Airport Surface Traffic Automation, utilizing earlier research and development to develop and demonstrate an airport surface surveillance, guidance and control system, implementable in steps and using the technologies used in the airspace system where practical.

b. **by improving and standardizing airport lighting, signage and marking to provide for safer airport operations during runway entry and turnoff, departure and crossing, reduction of runway occupancy time.**

◆ Near Term Actions

Improve airport surface visual control to permit efficient taxiway exit operations.

Complete development, validation and procedure development for stop bars and hold-short systems for runway entrances, intersections and ends

14. **Continue pavement design R&D to establish standard runway design criteria, improve pavement longevity, reduce impact of runway construction on airport operations, and obtain best value for AIP investment.**

Complete work to establish better data on runway friction and its operational relation to runway occupancy time.

◆ Near and Mid-Term Actions

Recommendations for well-focussed priority FAA R&D in this field has been supported by the Industry Task Force on Airport Capacity Improvement and Delay Reduction. The specific recommendations were transmitted to the FAA Administrator by the Airport Operators Council International on August 17, 1989.

Important capacity benefits can be achieved especially from research areas 3 and 4 of that document.

15. **The FAA aviation weather system must be substantially enhanced. Weather data, both near terminals and aloft, needs to improve dramatically. The safety-related weather information, such as wind shear, wake vortices, and thunderstorm, must be a priority. But effective terminal and enroute automation and sensible flow management all require the best possible weather and wind gradient information.**

    It is well recognized that the capacity of the national aviation system is a strong function of weather and that today's aviation weather is antiquated. Weather programs must address the deficiency in timely and accurate detection and prediction of aviation weather.

    ♦ Near Term Actions

    Timely completion and implementation of the National Aviation Weather Plan by the National Weather Service and FAA, which outlines needed improvements in collection and dissemination of aviation weather information, is imperative.

    Expedite the development and implementation of advanced aviation weather products critical for the enhancement of system safety and capacity. Safety and capacity-related products should include high resolution information of the 4-dimensional wind structure, CAT regions, convective areas to be avoided, terminal wind and shear conditions, icing and winter storm events.

    Advanced aviation weather information must be user-specific and should be available to all appropriate FAA (FSS, ARTCC, ATCT, CFCF), industry (meteorology centers, dispatch), and airport facilities.

The group's views should be coordinated with the Weather working group of the FAA Research and Development Advisory Committee.

16. **Assure optimum civil/military airspace use. Continue efforts to dynamically release special-use airspace for use in the civil system as soon as the military use is no longer required. Support rapid completion of the Military Airspace Management System and assure its tight integration with the FAA centralized traffic management system.**

17. **Expedite the development of FAA ground hardware, software and procedures to make full use of digital communications.**

◆ Near Term and Mid Term Actions

Expedite FAA work to begin to utilize data link to help achieve higher levels of automatic cooperation between a more sophisticated ATC system and more capable aircraft systems.

Expand use of ACARS for clearance delivery beyond currently planned locations. Automated ATIS and transmission of weather data are services which can reduce the growing voice communications burden on pilots and controllers.

Complete development of standardized methods and formats to use a variety of data links (ACARS, satellite links, Mode S).

18. **Complete and implement oceanic improvements to increase capacity and efficiency of over-ocean operations.**

◆ Near Term Actions

Complete remaining tasks to achieve early use of Automatic Dependent Surveillance using over-ocean satellite and data link communications services. Proceed rapidly to implement a satisfactory automated oceanic controller planning and display systems such as ODAPS and/or DOTS, with the ability to gather and utilize high quality weather and winds aloft data.

The system requirements and system functional characteristics must be closely coordinated with the programs of other ATC provider states. Automated oceanic ATC systems must be harmonized to ensure optimum use of the airspace and to create center/sector boundaries that are transparent to the users.

Complete analytical work to establish the basis for step-by-step reduction of oceanic separation standards.

19. **Demonstrate capabilities and develop procedures to exploit the capabilities of satellite navigation.**

The United States has embraced the concept of using space-based systems for the purpose of navigation. ICAO FANS has embraced a Global Navigation Satellite System (GNSS) concept which might utilize the satellites of several systems. The first system anticipated to become available will be the Global Positioning System (GPS).

Within the next three years, the U.S. Department of Defense will declare GPS operational. The high accuracy navigation capability of GPS, and of the ICAO-designated GNSS, has the potential of providing substantial capacity gains. The FAA must begin now to demonstrate the applicability of GPS and GNSS capabilities for civil aviation and develop procedures so that the systems can be beneficially exploited when the full system/s capabilities becomes operational. Experience gained with GPS will allow the rapid inclusion of other like systems if/when they become operational.

Until the full system/s are implemented and fully operational and their capabilities are fully demonstrated, the use of supporting/aiding systems is encouraged.

- Near Term Actions

Establish criteria for certification of satellite navigation as an autonomous (non-ground-aided) "sole means" of navigation when the system/s become operational.

Demonstrate and develop procedures for GPS-based and GNSS-based non-precision approaches.

Demonstrate and develop procedures for using satellite navigation-based curved/segmented approaches to ILS short finals.

Establish, through analysis and demonstrations, the potential of differential GPS and/or GNSS to support CAT I, II, III precision approaches.

Demonstrate ADS with GNSS as the navigation update.

Demonstrate the integration of GPS/GNSS into an aircraft flight management system for direct routing navigation.

Establish an FAA/industry effort (to include FAA Air Traffic Service, Flight Standards/procedures specialists, and the Satellite Program Office) to oversee the adoption and integration of satellite navigation capabilities into the ATC system.

Demonstrate the ability of the GPS/GNSS satellite navigation systems to provide positive guidance during missed approach procedures.

Create optimized FAA Flight Standards Terminal Instrument Procedures (i.e. TERPs) to realize timely benefits of stand-alone and aided/integrated satellite navigation systems.

Considering the capabilities of satellite navigation and other high accuracy navigation systems, establish the basis for reducing or eliminating TERPS requirements for independent IFR approaches to dual triple and quadruple runway configurations.

20. Conduct analyses and development to identify means to reduce runway occupancy time.

21. Establish appropriate roles for vision enhancement techniques.

♦ Mid Term Actions

Conduct an analysis of existing data from military and industry research and development to verify the capabilities of improved cockpit sensor and display technology for use in civil aviation cockpits. These technologies may help, by use of synthetic vision enhancement devices, to approach VMC system and airport capacity in IMC.

Concurrently, procedures for the use of such systems should be developed by FAA to provide for the use of this technology, if successful, to permit approaches to lower landing minima than are now achievable.

22. Explore methods to increase capacity through the use of more accurate and more-rapidly-updated surveillance displays for controllers.

FAA has clearly demonstrated the ability of high update-rate secondary surveillance radar to reduce the required minimum separation between runways for IFR independent approaches to parallel runways. It is possible that this same radar technology or different target tracking software may make possible a reductions in the required enroute or terminal area separation standards, and may thus increase capacity.

♦ Near Term Actions

Undertake a study to establish the capability of high-update-rate secondary surveillance radar (and primary radar if appropriate) to support reduction of separation standards.

Assess alternative target tracking software approaches that could provide more accurate and more frequent updates of target displays.

Establish the capacity gains to be expected from reduction of terminal area as well as enroute separation standards through the use of high-update-rate radar and/or advanced software display algorithms.

Determine the cost effectiveness of including these new technologies in planned new FAA specifications for secondary and primary radar, by comparing the increase in cost of such radar to the expected value of capacity gains.

23. Examination of the Basis for Current Separation Standards and TERPS Criteria

- Near Term Actions

While in recent years FAA has attempted to apply mathematical risk analysis to the development of separation standards, virtually all the standards in practical use are empirical and are based on the sound judgement of experienced operational experts. While analysis and mathematical risk assessments are valuable as guides, such analyses have not been successful in reflecting reality, and have inferred unacceptable risks in the use of standards which have been used with virtually perfect safety for decades. Similarly in current terminal procedures, the mathematical criteria applied to separate aircraft from ground obstacles would appear to yield unacceptable risks, but decades of use have proven otherwise.

These incongruities are serious when the fact is faced that the real impact of surveillance on the need for particular separation standards has not been analytically established, and that the early TERPS criteria for MLS, a system greatly superior to ILS, when mathematically reckoned, offered no apparent minimums credit for MLS.

Because procedures and separation standards have an important influence over the capacity and functioning of the future system, it will be necessary to undertake a practical assessment of current standards and how they are determined, and to develop a more rational method which more nearly represents actual experience.

STATEMENT
of
Cheryle Leon, President
Association of Professional Flight Attendants
1004 W. Euless
Euless, Texas

Before the Aviation Subcommittee of
the House Public Works and Transportation Committee

HEARING ON THE FINANCIAL CONDITIONS OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

February 6, 1991

Mr. Chairman and Members of the Committee:

I am Cheryle Leon, President of the Association of Professional Flight Attendants. APFA represents 18,000 Flight Attendants at American Airlines. I welcome the opportunity to testify before you today. APFA appreciates, Mr. Chairman, your longstanding leadership, along with that of the Subcommittee, on issues concerning the economic vitality of the airline industry. I am here today to discuss briefly why and how carrier labor relations present the single greatest economic challenge facing the U.S. airline industry now and for the decade to come. Simply stated, strong employee morale is fundamental to the financial health of the airline industry because this is the only way to achieve acceptable employee productivity.

While sharp hikes in fuel prices, security concerns and pilot labor shortages all related to the Persian Gulf War have contributed to the worsening financial condition of American and other carriers, the Persian Gulf War threatens to distract our attention from the more basic reason underlying poor domestic industry financial performance: employee morale. In the case of APFA, we have faced threats of job losses to foreigners; termination and other forms of harassment over our weight; and refusal to grant us a minimally acceptable CRAF agreement so that we may fly our troops to the Gulf (our carrier takes the view that CRAF flying does not differ from any of their international trips, and even refuses to give us gas masks or other safety equipment) for flights to Saudi Arabia.

Since deregulation, and especially since the Department of Transportation assumed the functions of the Civil Aeronautics Board in 1984, we have witnessed declining employee morale coupled with its twin, falling employee productivity. One of the devastating hallmarks of deregulation has been the systematic demoralization of one carriers' employee group after another.

For example, DOT and the FAA insisted for years that Eastern Airlines had no discernible safety problems despite overwhelming evidence from employees to the contrary. It took an independent grand jury's criminal indictments to demonstrate what DOT and FAA could have uncovered with reasonable diligence. Ignoring these employee complaints sent a clear signal to every airline worker in the country that legitimate safety concerns should not to be forwarded to the government, since they would be seen as nothing more than "labor disputes" (a favorite DOT term whenever employees try to identify carrier mistakes to public officials). I would suggest that such an attitude on the part of the Federal Government may be related to a notable decline in airline safety.

In remarks before the National Press Club on January 23, Secretary Samuel Skinner laid the blame for the sad demise of Eastern Airlines, and the decline of other carriers, at the feet of the carriers' unions' demands for equitable wages and working conditions. The facts simply do not bear out Secretary Skinner's conclusions. Some carriers are in trouble despite having given no wage increases in years. For example, TWA Flight Attendants have not received a raise in the last five years, and the rest of its employees work well below the industry average. Continental, a carrier in bankruptcy, has been at the bottom of the scale for nearly seven years. On the other hand, stronger domestic carriers like Delta, United and American have notably higher labor costs than those in financial trouble. Key foreign competitors, notably British Air, Lufthansa and KLM, also have notably higher labor costs than their U.S. counterparts but are neither economically distressed nor harming their consumers with excessive fares. Far more basic concerns about job security, deteriorating working conditions and aviation safety have undercut U.S. aviation employee morale, productivity and profitability.

Except where Congress has required regulatory action as in the smoking ban, we have seen complete DOT and FAA stagnation on many basic employee concerns about OSHA-like work place rules solely within DOT-FAA jurisdiction, such as duty time and rest limits for Flight Attendants. Imagine the message it sends to all U.S. Flight Attendants when DOT stonewalls for nearly eight years on rules needed to assure adequate rest and reasonable work limits for us when some 23 other countries already have them. Our efforts to improve cabin air quality, reduce radiation and impose weight restrictions on serving carts responsible for severe back injuries are routinely rebuffed.

The continued weakening financial condition of the airline industry foretells increased concentration in the industry. Even at the larger survivors like American, however, long term financial health is far from certain until our systemic problems are resolved. To do this, the federal government must consider a number of key measures.

First, United States cabotage laws should not be changed to allow foreign airlines authority to provide service between United States cities. This would undermine the policy goals served by current requirements that U.S. carriers employ only U.S. citizens or permanent resident aliens in such service. A loosening of U.S. restrictions could displace thousands of U.S. nationals on intra-U.S. routes. Such displacement could cause a large number of U.S. jobs to be lost in states like Minnesota, which border Canada, and Texas and California, which border Mexico. We all know that current Mexican labor costs are too low for us to compete with them. In light of the fact that non-resident aliens do not undergo drug testing or security background checks even when they fly in and out of the U.S., we find it outrageous that DOT would even consider any cabotage rules changes capable of permitting more foreigners to take our jobs.

Second, each transfer of international routes should be evaluated on its own merits. Critical to the thorough evaluation of a given route transfer is the availability of information concerning the impact of such transfers. DOT and the carriers' long-standing policy of shrouding all basic information about the transfers in the cloak of confidentiality not only stops employees from full, meaningful participation in DOT route transfer proceedings, but also undermines Congress and the public's ability to determine whether transfer of these routes serves the national interest. APFA has recently requested that DOT require that American Airlines and TWA voluntarily share important information about the London route transfer with the public and their employees.

Third, APFA believes that international route transfers often jeopardize the jobs of thousands of employees. This can often fatally cripple vitally needed morale and productivity at the selling carriers, while creating vast job uncertainty at the acquiring carriers. To solve this matter once and for all, APFA supports the transfer of jobs with routes. American and APFA successfully accomplished such a transfer of jobs with routes in our AirCal merger.

Fourth, before labor-management disputes threaten a vital national concern such as the aviation industry, the DOT should intercede far more frequently and aggressively to insist on rapid and equitable settlements. The leadership of former Labor Secretary Elizabeth Dole in resolving the Pittson Coal-United Mine Workers dispute exemplifies the role government should play in using political leadership effectively to advance national interests.

Fifth, DOT and FAA should issue long-delayed regulations establishing limitations on flight attendant duty times; take necessary steps to standardize flight attendant training; and issue regulations which would improve cabin air quality. Such concrete action would provide recognition that aviation professionals, particularly flight attendants, perform vital safety and security functions and would provide a tremendous boost to employee morale.

Most of these problems call for government oversight -- not better bargaining. The federal government should exercise leadership and cross over partisan boundaries to bring labor/management peace by stimulating employment stability and safety in the workplace. These elements are essential to improving employee morale and productivity. Good employee morale and high employee productivity are basic ingredients to restoring vitality to the domestic airline industry. Addressing these concerns responsibly now will enable the rest of the airline industry's problems to take care of themselves.

Thank you, Mr. Chairman, for your time and attention. I welcome any questions you or the other Members of the Subcommittee may have.

APFA
ASSOCIATION OF PROFESSIONAL FLIGHT ATTENDANTS
1004 WEST EULESS BLVD. • EULESS, TEXAS 76040 • (817) 540-0108

CONTACT: Pat Clarke
(212) 967-3180

HEAD OF AMERICAN AIRLINES FLIGHT ATTENDANTS UNION REJECTS TRANSPORTATION DEPARTMENT CRITICISM OF AIRLINE WORKERS

FOR IMMEDIATE RELEASE

WASHINGTON, DC, February 6, 1991--Cheryle Leon, President of the Association of Professional Flight Attendants (APFA) today rejected what she called the Bush Administration's "cynical attempt" to blame airline workers for the problems of the industry. The APFA represents the 18,000 flight attendants who work at American Airlines, the country's largest carrier.

Speaking before the House Aviation Subcommittee, Leon took issue with remarks made by Transportation Secretary Samuel Skinner in a National Press Club Address on January 23. "Skinner's speech was a cynical attempt to blame labor for the demise of Eastern and the difficulties of the airline industry in general," Leon said. "Skinner is far off the mark," she added.

"Skinner's allusions to high wages and excessive union power show that he is quite out of touch with actual conditions in the industry today," Leon said. "For the past decade, aggressive corporate policies have put unions on the defensive and eroded pay and working conditions," she added.

-more-

Leon also noted that there is no correlation between the carriers that are experiencing the most difficulties and relative wage levels. "Continental, which has been at the bottom of the wage scale, is now in Chapter 11, while a carrier like United with higher labor costs is in a much stronger position," Leon said.

Leon took the Transportation Department to task for weak enforcement of workplace safety regulations. "While Skinner is preoccupied with expanding foreign ownership of U.S. carriers, his Department has adopted a do-nothing approach to issues such as cabin air quality, radiation levels, and unfair flight attendant weight policies adopted by various companies."

Another concern voiced by Leon was in the area of cabotage: that is, the question of whether foreign airlines should be allowed to carry passengers from one U.S. city to another. "Skinner has taken an increasingly positive position on easing cabotage rules without considering the consequences for U.S. airline workers," Leon said.

"Allowing foreign carriers greater access to the U.S. market could endanger the jobs of thousands of U.S. employees," Leon said. "The Transportation Department should spend less time extolling competition and pay some attention to the possible impact of a change in cabotage policy," she added.

"If there is a labor problem in the airline industry today it is that workers increasingly feel they alone are being made to bear the burden of change," Leon said. "An industry that depends so much on personal service cannot afford to pursue policies that erode employee morale," she added. "Decent treatment of workers is one of the keys to the revival of the industry."

# # # #

ORAL STATEMENT

of

Cheryle Leon, President

Association of Professional Flight Attendants

1004 W. Euless Blvd.

Euless, Texas

Before the Aviation Subcommittee of

the House Public Works and Transportation Committee

HEARING ON THE FINANCIAL CONDITIONS OF THE AIRLINE INDUSTRY AND THE ADEQUACY OF COMPETITION

February 6, 1991

Mr. Chairman and Members of the Committee:

I am Cheryle Leon, President of the Association of Professional Flight Attendants. APFA represents 18,000 Flight Attendants at American Airlines. I welcome the opportunity to testify before you today. APFA appreciates, Mr. Chairman, your longstanding leadership, along with that of the Subcommittee, on issues concerning the economic vitality of the airline industry.

I am here today to discuss briefly why and how carrier labor relations present the single greatest economic challenge facing the U.S. airline industry now and for the decade to come. Simply stated, strong employee morale is fundamental to the financial health of the airline industry because this is the only way to achieve acceptable employee productivity.

While sharp hikes in fuel prices, security concerns and pilot labor shortages all related to the Persian Gulf War have contributed to the worsening financial condition of American and other carriers, the Persian Gulf War threatens to distract our attention from the more basic reason underlying poor domestic industry financial performance: employee morale. In the case of APFA, we have faced threats of job losses from the increasing employment of non-resident aliens; termination and other forms of harassment over our weight; and refusal to grant us a minimally acceptable CRAF agreement so that we may fly our troops to the Gulf (our carrier takes the view that CRAF flying does not differ from any of their international trips, and even refuses to give us gas masks or other safety equipment for flights to Saudi Arabia).

Since deregulation, and especially since the Department of Transportation assumed the functions of the Civil Aeronautics Board in 1984, we have witnessed declining employee morale. One of the devastating hallmarks of deregulation has been the systematic demoralization of one carriers' employee group after another.

In remarks before the National Press Club on January 23, Secretary Samuel Skinner made a cynical attempt to blame labor for the demise of Eastern and the difficulties of the airline industry in general. He was far off the mark.

The facts simply do not bear out Secretary Skinner's conclusions. Some carriers are in trouble despite having given no wage increases in years. For example, TWA Flight Attendants have not received a raise in the last five years, and the rest of its employees work well below the industry average. Continental, a carrier in bankruptcy, has been at the bottom of the scale for nearly seven years. On the other hand, stronger domestic carriers like Delta, United and American have notably higher labor costs than those in financial trouble.

Key foreign competitors, including British Air, Lufthansa and KLM, also have higher labor costs than their U.S. counterparts but are neither economically distressed nor harming their consumers with excessive fares. Far more basic concerns about job security, deteriorating working conditions and aviation safety have undercut U.S. aviation employee morale, productivity and profitability.

By alluding to high wages and excessive union power, Secretary Skinner showed that he is quite out of touch with actual conditions in the industry today. For the past decade, aggressive corporate policies have put unions on the defensive and eroded pay and working conditions.

By focusing on the supposed excessive power of airline unions, Secretary Skinner ignored what we see as the real problems. While DOT is preoccupied with expanding foreign ownership of U.S. carriers, it has adopted a do-nothing approach to health and safety issues such as cabin air quality and radiation levels.

For example, DOT and the FAA insisted for years that Eastern Airlines had no discernible safety problems despite overwhelming evidence from employees to the contrary. It took an independent grand jury's criminal indictments to demonstrate what DOT and FAA could have uncovered with reasonable diligence. Ignoring these employee complaints sent a clear signal to every airline worker in the country that legitimate safety concerns should not be forwarded to the government, since they would be seen as nothing more than "labor disputes" (a favorite DOT term whenever employees try to identify carrier mistakes to public officials).

I would suggest that such an attitude on the part of the Federal Government may be related to a decline in airline safety.

Except where Congress has required regulatory action as in the smoking ban, we have seen complete DOT and FAA stagnation on many basic employee concerns about safety and health that fall solely within DOT-FAA jurisdiction, such as duty time and rest limits for Flight Attendants. Imagine the message it sends to all U.S. Flight Attendants when DOT stonewalls for nearly eight years on rules needed to assure adequate rest and reasonable work limits for us when some 23 other countries already have them. While DOT has implicitly sanctioned unfair company policies on flight attendant weight, it has ignored our efforts to impose weight restrictions on serving carts responsible for severe back injuries.

The continued weakening financial condition of the airline industry foretells increased concentration in the industry. Even at the larger survivors like American, however, long term financial health is far from certain until our systemic problems are resolved. To do this, the federal government must consider a number of key measures.

First, United States cabotage laws should not be changed to allow foreign airlines authority to provide service between United States cities. DOT has taken an increasingly positive position on easing cabotage rules without considering the consequences for U.S. airline workers. Allowing foreign carriers greater access to the U.S. market could endanger the jobs of thousands of U.S. employees.

Such changes would undermine the policy goals served by current requirements that U.S. carriers employ only U.S. citizens or permanent residents in such service. Displacement could cause a large number of U.S. jobs to be lost in states like Minnesota, which border Canada, and Texas and California, which border Mexico. We all know that current Mexican wages are too low for us to compete with them. The

Transportation Department should spend less time extolling competition and pay some attention to the possible impact of a change in cabotage policy.

Second, each transfer of international routes should be evaluated on its own merits. Critical to the thorough evaluation of a given route transfer is the availability of information concerning the impact of such transfers. DOT and the carriers' long standing policy of shrouding all basic information about the transfers in the cloak of confidentiality not only stops employees from full, meaningful participation in DOT route transfer proceedings, but also undermines Congress and the public's ability to determine whether transfer of these routes serves the national interest. APFA has recently requested that DOT require that American Airlines and TWA voluntarily share important information about the London route transfer with the public and their employees.

Third, APFA believes that international route transfers often jeopardize the jobs of thousands of employees. This can cripple vitally needed morale and productivity at the selling carriers, while creating vast job uncertainty at the acquiring carriers. To solve this matter once and for all, APFA supports the transfer of jobs with routes. American and APFA successfully accomplished such a transfer of jobs with routes in our AirCal merger.

Fourth, before labor-management disputes threaten a vital national concern such as the aviation industry, the DOT should intercede far more frequently and aggressively to insist on rapid and equitable settlements. The leadership of former Labor Secretary Elizabeth Dole in resolving the Pittston Coal-United Mine Workers dispute exemplifies the role government should play in using political leadership effectively to advance national interests.

Fifth, DOT and FAA should issue long-delayed regulations establishing limitations on flight attendant duty times; take necessary steps to standardize flight attendant training; and issue regulations which would improve cabin air quality. Such concrete action would provide recognition that aviation professionals, particularly flight attendants, perform vital safety and security functions and would provide a tremendous boost to employee morale.

Most of these problems call for government oversight--not better bargaining. The federal government should exercise leadership and cross over partisan boundaries to bring labor/management peace by stimulating employment stability and safety in the workplace. These elements are essential to improving employee productivity. Good employee morale and high employee productivity are basic ingredients to restoring vitality to the domestic airline industry.

If there is a labor problem in the airline industry today it is that workers increasingly feel they alone are being made to bear the burden of change. An industry that depends so much on personal service cannot afford to pursue policies that erode employee spirit and commitment. Decent treatment of workers is one of the keys to the revival of the industry. Addressing these concerns responsibly now will enable the rest of the airline industry's problems to take care of themselves.

Thank you, Mr. Chairman, for your time and attention. I welcome any questions you or the other Members of the Subcommittee may have.

United States General Accounting Office

GAO Testimony

*For Release
on Delivery
Expected at
9:30 a.m. EST
Wednesday
February 6, 1991*

U.S. AIRLINES

Weak Financial Structure Threatens Competition

Statement of
Kenneth M. Mead
Director, Transportation Issues
Resources, Community, and Economic
Development Division

Before the
Subcommittee on Aviation
Committee on Public Works and
Transportation
House of Representatives

Mr. Chairman and Members of the Subcommittee:

We appreciate this opportunity to testify on the financial condition of the airline industry and its effects on competition. The deterioration of the industry's financial health over the past several years has raised concerns that, as carriers are forced out of the industry due to bankruptcy, competition will decline and prices will rise. This could undermine the gains achieved for airline passengers since deregulation. The analysis we are presenting today is based on our recent assessment of the financial condition of the airline industry and on the work we have done over the past three years, much of which has been reported to you in a series of reports and testimonies, on competition in the airline industry.

Overall, our work suggests the following:

-- First, the airline industry has developed over the past decade some serious long-term problems that weaken the financial position of some carriers. Chief among these problems are (1) the high levels of debt that some carriers have incurred and (2) the operating and marketing practices that some carriers have adopted that prevent other carriers from competing effectively. More recently, the industry has also been hit by two severe short-term problems--the ongoing recession and high fuel prices resulting from the Iraqi invasion of Kuwait. The short-term problems have exacerbated the financial weakness that has been building up over the past decade. Future investment demands, for repairing aging aircraft and meeting more stringent noise standards, will increase the financial burdens on the industry.

-- Second, financial problems threaten the survival of several carriers. Eastern and Braniff have already ceased operations within the past two years; if the recession is prolonged, several additional carriers could fail.

-- Third, if several airlines do fail to survive the recession, competition could be adversely affected. Many routes are served by only two or three carriers, so the loss of a single airline could significantly reduce competition. If carriers do cease operations, careful monitoring of sales of assets by the Department of Transportation (DOT) and the Department of Justice can help to mitigate reductions in competition by encouraging the sale of assets to carriers that did not previously offer service on the affected routes.

-- Fourth, the potential reduction in competition that could result if several carriers cease operations lends greater urgency to the need to take further action to enhance the industry's competitive balance. In our previous testimony before this Subcommittee, we discussed a number of policy initiatives to promote competition in the airline industry.[1] One of these, passenger facility charges at airports, was authorized last year by the Congress. It should help provide revenues to airports to expand capacity without needing the approval of airlines. Other policies we discussed, such as reducing the anticompetitive impact of computerized reservation systems, have been subjected to prolonged review by DOT. These policies would both improve the financial health of carriers whose survival is threatened and help to mitigate any loss of competition resulting from carriers ceasing operations. While these policies would enhance the competitive strength of the smaller carriers in the industry, the long-term problem of excessive debt in the industry would remain.

---

[1] Barriers to Competition in the Airline Industry (GAO/T-RCED-89-66, Sept. 21, 1989).

-- Fifth, the urgent need of some carriers for additional capital has led to calls for legislation to allow foreign firms more opportunity to invest in U.S. carriers. Insofar as such action goes beyond the policy changes recently announced by the Secretary of Transportation, it could lead to greater control of U.S. carriers by foreign interests, and would require careful review for its impacts on national defense and our bilateral negotiating strategy. Any general opening of the U.S. market to foreign interests should take place as part of a reciprocal process which allows U.S. carriers more access to foreign markets.

-- Sixth, more far-reaching policy options, such as reregulation of fares or federal financial assistance for the industry, pose serious problems that would require extensive analysis before they could be considered for implementation. These approaches are at odds with the policy expressed in the Airline Deregulation Act of 1978, which emphasizes competition as the primary regulator of airline fares.

HIGH DEBT LEVELS AND OBSTACLES TO COMPETITION HAVE WEAKENED THE FINANCIAL HEALTH OF SOME CARRIERS

Debt Levels Have Increased Substantially For Some Carriers

Debt levels increased substantially for some carriers during the 1980's, either as a result of leveraged buyouts or to finance expansion. This debt was taken on under the assumption that the demand for airline travel would grow at a sufficiently steady pace to generate the revenues to pay the debt service. These assumptions are now proving to have been overly optimistic. The increase in debt increases fixed charges for interest payments and makes these carriers much more vulnerable to a short-run decrease in demand due to a recession or a short-run increase in costs.

One standard measure of debt levels is long-term debt as a percentage of total capitalization. Between 1980 and 1989, this percentage rose from 62 percent to 273 percent at Pan Am, from 62 percent to 115 percent at TWA, and from 62 percent to 96 percent at Continental. (See attachment I.) The debt to capitalization ratio at Eastern rose from 79 percent in 1980 to 473 percent in 1988.[2] America West raised its debt level from 45 percent to 85 percent between 1983 and 1989, while Midway's went up from 52 percent to 78 percent.[3] By contrast, despite a vigorous expansion program, American Airlines actually reduced its debt ratio during this period to 34 percent, while United, USAir, Southwest, Delta, and Northwest all held their debt ratios under 60 percent.

These data include capitalized leases (that is, leases for the lifetime of the asset), but may not include other long-term leases. Some analysts believe all long-term leases should be included as part of debt, which would make these debt ratios higher. One estimate for American and United places their debt ratios at 70 percent and 75 percent, respectively, including long-term leases and short-term debt.

Industry Operating and Marketing Practices Limit Competition

At the same time, as we have reported previously, some operating and marketing practices used in the airline industry limit competition and make it more difficult for some carriers to compete.[4] These practices limit access to airports and limit the ability of new carriers on a route to market their services.

---

[2] 1989 data for Eastern are not comparable due to Eastern's bankruptcy.

[3] America West is a relatively new airline that only began reporting in 1983. Midway began reporting in 1982.

Some Practices Limit Access to Airports

Airport access is limited by the practice of leasing airport gates and other facilities to airlines on long-term exclusive-use leases. These leases give control of these facilities to airlines and make it possible for them to exclude other airlines from the use of the facilities. At some airports, most of the facilities at the airport are controlled by a single airline. Another practice that limits access to airports is the majority-in-interest clause. This provision in the airport use agreement typically gives the airlines providing a majority of the operations at an airport the right to disapprove expansions in capacity by the airport which would alter the airlines' financial commitment to the airport. These clauses thus potentially prevent capacity expansions that could accommodate another carrier. Our analysis showed that carriers charge significantly higher fares on routes to airports where they control a large portion of the gates or where a majority-in-interest clause is in effect. Last October the Congress passed legislation authorizing airports to levy Passenger Facility Charges. These charges, by giving the airports a source of revenues independent of the airlines, should help the airports to expand capacity without seeking airline approval.

Another factor limiting airport access is the Federal Aviation Administration's (FAA) High Density Rule, which restricts access to takeoff and landing "slots" at National Airport in Washington, LaGuardia and JFK Airports in New York, and O'Hare Airport in Chicago. Our analysis showed that carriers charge higher fares on routes where slot controls are in effect. While these practices enhance the revenues of carriers who have established positions at these airports, they make it more difficult for other carriers to compete and earn an adequate profit.

---

[4] Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

Marketing Practices Limit the Ability of Airlines Entering New Markets to Compete

Airline marketing practices also limit competition. Over two years ago, we testified before this Subcommittee on the competitive impacts of computerized reservation systems (CRS).[5] Because each carrier must, as a practical matter, have its flights listed on each of the four CRSs in order to market its flights successfully, each carrier is forced to pay the booking fees charged by the other airlines that own the CRSs. These booking fees far exceed the costs of providing the service, and hence transfer hundreds of millions of dollars in revenues from carriers that do not own CRSs to those that do. Even a carrier that owns a CRS loses money if it pays out more in booking fees for flights booked on other systems than it receives from other carriers' flights booked on its system. Because of restrictive contract provisions between CRS vendors and travel agents, it is virtually impossible for a new CRS to be established or for a small CRS to expand its market share. While most of the major carriers are now part-owners in CRSs, most of the benefits of these systems go to the two majority owners of the two dominant systems, American and United. We calculated that the lack of effective competition in the CRS industry allows American and United each to receive over $300 million per year in excess of the costs of the service provided (including a reasonable profit) from other carriers in the industry, most of which are financially weaker.

Frequent flyer plans may also have a significant effect in reinforcing the market power of dominant carriers. Our survey of travel agents indicated that business flyers often choose their carrier based on frequent flyer plans, which generally favor the larger carriers in each market. Travel agent commission overrides (bonus commissions paid to travel agents to encourage booking on a particular carrier) may also restrict competition, but their effect is less clear.

---

[5] Competition in the Airline Computerized Reservation System Industry (GAO/T-RCED-88-62, Sept. 14, 1988).

Code-sharing agreements (cooperative marketing agreements between jet carriers and commuter carriers) appear to strengthen the position of carriers with such agreements, especially at their hubs. In doing so, these agreements prevent other carriers from competing effectively. Code-sharing agreements might also reduce the long-run competitiveness of the industry by making regional carriers less independent and preventing them from potentially offering a competitive challenge to larger carriers in some markets.

The Recession and High Fuel Prices Have Worsened Carriers' Financial Problems

Airline industry profitability has been low for several years. The industry lost money in 4 out of the 10 years from 1980 to 1989. Passenger airlines earned a profit of $1.2 billion in 1988, but have become increasingly distressed since then.[6] They lost $20.7 million in 1989 and appear headed for a record loss of over $2 billion in 1990. (See attachment II.) The recent decline in profitability is due primarily to the decline in the health of the economy and to the rise in the price of fuel.

Capacity is Up, But Demand Is Flat

The demand for airline service tends to rise and fall with the overall level of national income. Gross national income grew very slowly in 1990, rising 1.0 percent during the first three quarters before dropping 0.5 percent in the fourth quarter. Meanwhile, domestic airline industry capacity in 1990 grew faster than demand, rising by 5.5 percent over 1989 capacity. Fares rose slightly, but less than the increase in operating costs.

---

[6] Our analysis includes the eleven major airlines and Midway.

Fuel Prices Are Up

The domestic cost of jet fuel rose 97 percent during the first months of the Persian Gulf Crisis, from $.56 per gallon in July to a peak of $1.11 in October. Our preliminary analysis indicates that the increase in fuel costs from July to October pushed up total operating costs up by more than 10 percent. By January 30th, the price of fuel had fallen to $.70, a decline of 37 percent from the October peak. While there is no organized futures market for jet fuel, futures prices for other refined petroleum products suggest that prices are expected to fall further over the course of the year.

Reduced Profits Have Weakened Carriers' Ability to Service Their Debt

As profits have declined, carriers have been less able to service their debt. Earnings before interest and taxes in the 3rd quarter of 1990 were less than interest charges for 6 of the 11 major carriers (America West, Continental, Delta, Eastern, Pan Am, and USAir), and almost certainly declined further in the 4th quarter.

FUTURE INVESTMENT DEMANDS WILL IMPOSE FURTHER FINANCIAL STRAINS ON THE INDUSTRY

Investment demands for replacing and renovating aircraft will continue to be heavy due to increasingly stringent FAA airworthiness directives and new federal requirements to phase out older, noisier jets. The FAA recently issued new airworthiness directives for aging aircraft requiring repairs and modifications to about 1,400 of the 4,100 aircraft in the U.S. fleet, at a cost of about $500 million per year over the next 4 years. Moreover, the recently enacted Aviation Noise and Capacity Act of 1990 requires that all aircraft meet stringent "stage 3" noise standards by the year 2000. We estimated that this will require the retrofitting or early replacement of over 2,000 aircraft over the next 10 years at a cost of about $2.2 billion. These changes are essential to meet compelling safety and noise abatement objectives, but they will place a substantial financial burden on the industry.

THESE FINANCIAL PROBLEMS THREATEN THE SURVIVAL OF SEVERAL CARRIERS

Several carriers, including Pan Am, Continental, and TWA, have been plagued by high debt and low profits. Pan Am and Continental have both filed for protection from their creditors under Chapter 11 of the bankruptcy code. Midway also has a high level of debt (though less than these other three carriers), and lost money in both 1989 and 1990. America West made a profit in 1989, but lost money in 1990 and also has a high debt level. USAir has a low debt level, but lost money in both 1989 and 1990. These carriers are all, to varying degrees, threatened by the declining financial fortunes of the industry. For the stronger carriers in the industry, on the other hand, the recent decline in profitability will probably cause temporary financial distress but should not lead to any long-term problems. American, Delta, Northwest, Southwest, and United all have reasonably low debt levels and turned a profit in 1989. The likelihood of any particular carrier surviving depends on the strength of various elements of its balance sheet, its ability to compete effectively, the level of fuel costs, and the length of the recession. A carrier's balance sheet evolves continuously as it takes out additional loans and acquires new assets. We are not prepared to assess the prospects of survival of any particular carrier, but clearly several carriers are threatened.

COMPETITION COULD BE HARMED IF ADDITIONAL CARRIERS CEASE OPERATIONS

If additional carriers cease operations, the decline in the number of competing carriers will probably harm competition. The four carriers in the weakest financial condition (including Eastern) collectively carried about 27 percent of the industry's traffic last year. (See attachment III.) Our analysis of industry pricing demonstrates that carriers are able to charge higher prices on routes where they have higher market shares. Our analysis indicates that doubling a carrier's market share on a route, e.g., from 10 percent to 20 percent, is associated on average with an increase in prices of almost 9 percent. As carriers cease operations, we would expect the market shares and fares of the remaining carriers to rise.

Before it ceased operations, Eastern had at least a 10-percent market share on 10 percent of the nation's routes. Continental and TWA have such shares on 14 percent and 12 percent of the nation's routes, respectively. Pan Am, by contrast, is primarily an international carrier and has at least a 10-percent share on less than 1 percent of the nation's domestic routes. (See attachment IV.)

It has been suggested that the survival of four or five carriers would be enough to achieve effective competition. This would be true if several carriers served most routes. However, about 76 percent of all passengers nationwide fly on routes served by three or fewer carriers, and 45 percent fly on routes served by only one or two carriers. On these routes, the loss of a single carrier could have a serious adverse effect on competition.

The nature of the competitive outcome would depend, of course, on how other carriers responded to the failing carrier's exit. If a failing carrier were able to sell its hub operation to another carrier that did not already provide service on its routes, then competition might not be adversely affected, because market shares would be no higher than before. However, the acquiring carrier will probably have been providing service already on some of the routes acquired from the failing carrier, and competition would be adversely affected on those routes. The exit of one carrier would probably make the remaining carriers on its routes stronger. The ultimate outcome is uncertain, but the potential loss of competition could significantly raise fares.

The loss of competition when a carrier ceases operations can be reduced if the DOT and the Department of Justice monitor sales by the failing carrier of its geographically fixed assets, such as gates and slots, to ensure that these sales do not result in avoidable losses of competition. As the Subcommittee is aware, review of competitive impacts by DOT has sometimes been cursory in the past, when mergers were assumed to have no impact because of the role of "potential competition."[7] DOT and Justice have stated that they are currently monitoring asset sales by Eastern Air Lines, and Justice has recently requested additional information concerning proposed sales of Eastern's assets. The sale of Eastern's gates in Atlanta to Delta Air Lines, which already dominates routes from Atlanta, would significantly reduce competition in the Atlanta market, where fares since deregulation have already increased more on average than in any other major hub market.[8]

---

[7] See our report, Airline Competition: DOT's Implementation of Airline Regulatory Authority (GAO/RCED-89-93, June 28, 1989).

[8] See our report, Airline Competition: DOT and Justice Oversight of Eastern Air Lines' Bankruptcy (GAO/RCED-90-79, Feb. 23, 1990).

POLICY INITIATIVES TO PROMOTE COMPETITION SHOULD ALSO PROMOTE FINANCIAL HEALTH

The declining financial health of several carriers has led to numerous suggestions for policy initiatives to improve their financial condition. Some of these suggestions deal with the short-run problems of the industry. These include forcing down the price of jet fuel, either through federal government pressure on oil companies or through release of petroleum from the Strategic Petroleum Reserve, and allowing airlines to retain for a time the revenues from the airline ticket tax. Other suggestions are addressed to the long-term problems of the industry, such as proposals to set a floor on airline fares so as to increase revenues and to ease the rules that restrict investments by foreign entities in U.S. carriers. We believe that a more effective and appropriate approach would focus on policies to enhance competition--such as revised rules on slot allocation and computerized reservation systems--that we have discussed in previous testimony before this Subcommittee. This would both enhance the financial conditions of threatened carriers and mitigate any reduction in competition that would occur if additional carriers ceased operations.

Short-run Policy Approaches

Reducing the Price of Jet Fuel

The price of jet fuel has already fallen considerably from the peak levels reached this fall. Prices are still higher than the levels being paid in July; however, the early achievement of air superiority in the Persian Gulf War, coupled with the President's decision to release petroleum from the Strategic Petroleum Reserve, has created expectations that prices will fall even further. A prolonged war could, of course, reverse these expectations. In any case, reducing fuel prices will not solve the more fundamental problems, such as limited access to airports and restrictive marketing practices, that limit the competitiveness of the airline industry.

Allowing Airlines to Retain Revenues From the Airline Ticket Tax

Airlines collect a 10-percent excise tax on the price of airline tickets, which they remit to the federal government for deposit in the Airport and Airway Trust Fund. Allowing airlines to retain revenues from the airline ticket tax would be an indirect form of federal financial assistance for the industry. The airlines would increase their cash flow and reduce their need to borrow, but these savings would come at the expense of the federal government, which would have to borrow more to replace the lost cash flow and incur increased interest charges. Moreover, such financial assistance would be at odds with one of the purposes of the Airline Deregulation Act of 1978, to reduce the role of the federal government in the airline industry.

GAO has had extensive experience with previous bailouts, including those for Conrail, Lockheed, Chrysler, and New York City (the Comptroller General served on the boards that oversaw the financial assistance provided to Conrail and Chrysler). In a previous report, GAO reviewed the experience with these bailouts and set out a series of guidelines that should be followed before any additional such bailouts are authorized.[9] These guidelines are that the problem should be clearly identified, the national interest should be clearly established, the objectives of the bailout should be clear and consistent, and the government's financial interests should be protected. Given the dramatic increase in federal budget deficits since these other bailouts were authorized, it is especially important that any proposal for financial assistance to the airline industry address the national interest to be served by rescuing any individual airline and how such a bailout could be structured to protect the government's financial interests. Finally, and more fundamentally, other steps to enhance the competitiveness of the airline industry should be taken before financial assistance is considered.

---

[9] Guidelines for Rescuing Large Failing Firms and Municipalities (GAO/GGD-84-34, March 29, 1984).

Long-run Policy Approaches

Reregulation of Fares

Reregulation of fares would reverse the pro-competitive policy established by the Congress in 1978, would be cumbersome to implement, and might well be ineffective in halting the slide in airline profits. Carriers with weak reputations for passenger service quality might be able to compete effectively only by offering lower fares than their competitors. Forcing them to charge the same fares as their competitors might reduce their traffic levels and hasten their exit from the industry, rather than retard it. Reregulation of fares would also be extremely cumbersome administratively. Carriers vary the number of seats they sell at each fare level on each flight. A regulator would need either to regulate the number of seats sold at each fare level on each flight, which would be extremely cumbersome, or to reduce the airlines' freedom to vary their fares, which would probably reduce, rather than increase, their revenues. Given the current size of airline fleets, discount airfares are needed to fill the seats, and the airlines can much better assess the level of pricing that will maximize their revenues from that capacity than the federal government can. Eliminating discount seats would also exclude price-sensitive passengers who could not afford to fly at higher fares.

Opening U.S. Airlines to More Foreign Investment

Improving access of poorly financed carriers to capital might reduce their cost of capital and enhance their ability to survive. One option for the Congress to consider would therefore be easing the rules that restrict investments by foreign entities in U.S. carriers. The Secretary of Transportation recently relaxed these rules so as to allow unlimited access to debt capital from foreign sources and access to non-voting foreign equity capital up to 49 percent of an airline's total equity. The 25-percent limit on voting foreign equity, which is fixed by statute, of course remains in effect.

The unlimited access to foreign debt capital is subject to the condition that the loan not provide "special rights" to the debt holder that might imply control. While the order does not specify what kinds of special rights are meant, the rights that have concerned DOT in the past include the foreign creditor's right to name a management advisory committee and its right to enter into exclusive marketing agreements with the U.S. carrier. We would also be concerned with what rights of recourse the foreign creditor has in the event of default.

Increasing this access significantly beyond what the Secretary has already announced could effectively give control of U.S. carriers to foreign entities. We would therefore urge caution in authorizing such access. If foreign carriers were allowed to buy effective control of U.S. carriers, we would in effect be giving these foreign carriers cabotage rights (i.e., the right to provide domestic service) in the United States. This would raise legitimate concerns. For example, foreign control of U.S. carriers might compromise their key national defense role. Under the Civil Reserve Air Fleet program, they are required to make available certain aircraft for military airlift. This airlift has been a critical part of the mobilization for the Persian Gulf war. Also, allowing foreign ownership of U.S. carriers would complicate the bargaining strategy of the U.S. government in negotiating international route rights. Finally, many foreign carriers are government owned and subsidized. Allowing such carriers to compete in the U.S. market could distort the competitive process. We are currently investigating these issues at the request of the Senate Commerce Committee.

The creation of a single market in Europe in 1992 is likely to lead to efforts to renegotiate bilateral agreements governing access by U.S. carriers to Europe. Any action to allow foreign ownership of U.S. carriers or access by foreign carriers to U.S. domestic markets should be part of a reciprocal arrangement that allows U.S. carriers greater access to foreign markets.

Improving Financial Health by Promoting Competition

The government's interest in the survival of threatened carriers is primarily one of ensuring that enough carriers survive to provide effective competition. At the same time, the goal of federal competition policy is to protect competition, not to protect competitors. A policy that protected inefficient competitors (for example, through some kind of subsidy) could injure, not protect, competition. Ultimately, the only way to ensure the survival of enough firms to maintain competition is to ensure that the industry remains open to market entry. The government's interest is to ensure that a "level playing field" exists so that the weaker carriers still in business can provide safe and cost-effective service in competition with the stronger carriers.

In our previous reports and in testimony before this Subcommittee, we discussed several policies that could enhance the financial health of the weaker carriers while also promoting competition.[10] While some of the stronger carriers might lose some control over their markets if these policies were implemented, we believe that the weaker carriers would, in general, gain, and that the competitive balance of the industry would improve.

Improving Access to Airports

Our previous testimony focused on two policy objectives--easing access to airports and reducing the marketing advantages of dominant carriers. The recent passage of legislation authorizing passenger facility charges is one step toward easing access to airports. It should allow airports to expand their facilities without seeking approval from dominant airlines. An additional step in this direction would be to encourage the use of preferential-use leases (rather than exclusive-use leases) of airport facilities to airlines. Preferential-use leases allow carriers other than the primary lessee to use gates and other facilities when they are not needed by the primary carrier.

Revisions to the slot rule could ease access to the four slot-controlled airports and enhance the competitive status of carriers like America West and Midwest Express that currently have very limited access to these airports. Such revisions are currently under consideration by the DOT. DOT has been considering such changes for over two years. Although a proposed rule has been drafted, the review process at the Office of Management and Budget may delay its issuance for a few months, and a final rule would come at least several months after that.

---

[10] For example, Barriers to Competition in the Airline Industry (GAO/T-RCED-89-66, Sept. 21, 1989) and Airline Competition: Industry Operating and Marketing Practices Limit Market Entry (GAO/RCED-90-147, Aug. 29, 1990).

Reducing Barriers Resulting From Marketing Practices

We testified before this Subcommittee over two years ago on ways of revising DOT's rules governing computerized reservation systems (CRSs) so as to improve their competitive impact.[11] Options to remedy this problem include eliminating booking fees, establishing a common CRS governed by a consortium of airlines, and eliminating minimum-use clauses and minimum 5-year terms from contracts between CRS vendors and travel agents. As with the slot rule, DOT has been considering revision of its CRS rules for more than a year; it has prepared a draft proposed rule that will not be issued for at least several more months.

Frequent flyer plans also have a substantial potential to limit competition. Policies that would restrict these plans might enhance competition and strengthen weaker carriers.

CONCLUSIONS

The protracted financial distress of the airline industry threatens the survival of several carriers. An industry with four or five carriers might, as has been suggested, be effectively competitive if several carriers served most routes. But given the barriers to market entry that exist, there is no assurance that new carriers would enter existing routes to replace carriers that ceased operations. Action should therefore be taken now to ensure that the structural conditions exist for effective competition in the airline industry. The need for action on this problem has been apparent for at least the past two years. The failing financial health of several carriers makes this need even more urgent. DOT has been considering new rulemakings on slots and CRSs for over a year, and even proposed rules still appear to be months away.

---

[11] Competition in the Airline Computerized Reservation System Industry (GAO/T-RCED-88-62, Sept. 14, 1988).

Continued delay by DOT may result in these reforms taking effect so late that they will no longer be effective in preserving competition. Other action, to encourage use of preferential-use gate leases at airports and to restrict frequent flyer plans, should also be considered. While opening the U.S. market to foreign competition might offer some long-run hope for improved competition, such changes would be most appropriate in the context of a reciprocal agreement for improved access to foreign markets.

Deregulation of the airline industry has generally brought lower fares and better service to most Americans. But the benefits of deregulation could be lost if the industry collapses into a tight oligopoly, controlled by a handful of firms, into which new entry is effectively precluded. Even an improvement in the competitive environment within which the industry operates will be to no avail, however, if firms continue to burden themselves with excessive debt.

That concludes my statement. We would be happy to respond to any questions you might have.

LONG-TERM DEBT AS A PERCENTAGE OF TOTAL CAPITALIZATION, 1980-1989

Airline	1980	1981	1982	1983	1984	1985	1986	1987	1988	1989
Pan Am Corp.	62.0	58.8	77.3	71.9	82.2	60.5	99.0	132.3	151.1	272.9
Eastern	78.5	83.8	89.0	93.2	87.6	84.0	90.7	97.3	473.3	(52.9)[a]
TWA[b]	61.8	66.6	70.3	65.4	66.7	75.5	94.2	89.8	101.3	114.8
Continental[c]	62.3	53.7	92.6	308.9	123.9	95.9	97.3	85.4	96.3	96.3
America West	--	--	--	44.7	75.7	65.9	81.5	89.0	86.9	84.5
Midway	--	--	57.2	52.0	62.3	44.1	34.9	50.8	46.5	78.0
UAL Corp.	45.2	48.2	58.3	41.5	31.1	56.7	45.8	32.7	62.7	46.1
Air Wisconsin	71.2	49.9	35.1	46.6	48.2	54.5	51.4	47.5	39.9	41.8
Alaska	--	--	39.9	40.0	48.2	54.0	56.6	39.5	32.7	37.1
AMR Corp.	63.4	66.4	64.2	51.2	47.2	43.7	45.1	45.0	41.0	33.5
USAir[d]	44.0	42.6	37.9	31.8	31.7	27.7	24.8	44.5	35.6	44.8
Southwest	38.0	22.2	27.2	29.6	25.7	40.3	35.3	29.5	35.6	33.4
Delta[e]	10.6	12.4	20.2	45.0	30.4	22.0	33.4	28.7	21.0	18.3
NWA Inc.[f]	5.4	1.1	0.0	8.2	7.9	29.3	50.8	34.4	32.1	--
Industry Average	53.5	54.8	60.3	57.3	52.5	52.6	56.8	54.6	53.6	56.2

Source: Salomon Brothers Stock Research, The Financial Condition of the U.S. Airline Industry at Year-End 1989, by Julius Maldutis, Ph.D., July 1990, Figure 10, p. 7. Data are drawn from company reports.

[a] 1989 data for Eastern are not comparable with previous years' data due to Eastern's bankruptcy.

[b] TWA's data for 1986 and subsequent years reflects its acquisition of Ozark on September 15, 1986.

[c] Prior to December 31, 1986, $653.9 million in liabilities was subject to Chapter 11 reorganization proceedings. Financial ratios and data for 1983, 1984 and 1985 do not include any of the liabilities subject to reorganization proceedings.

[d] USAir's data for 1987 and subsequent years reflects its acquisition of Piedmont on November 5, 1987.

[e] Delta's data for 1987 and subsequent years reflects its acquisition of Western on December 18, 1986.

[f] NWA Inc. was acquired by Wings Acquisition, Inc. on August 4, 1989. Consequently, company reports for NWA Inc. are not available for 1989. NWA's data for 1986 and subsequent years reflects its acquisition of Republic on August 12, 1986.

NET PROFIT (LOSS) BY AIRLINE

Millions of dollars

Airline	Full year 1988[a]	Full year 1989[a]	First quarter 1990[b]	Second quarter 1990[b]	Third quarter 1990[b]	Fourth quarter 1990[c]
America West	9.4	20.0	(2.6)	6.1	(22.0)	--
American	449.4	423.1	(30.7)	120.0	54.1	(215.1)
Continental	(315.5)	3.1	21.3	96.8	(55.1)	--
Delta	344.5	473.2	31.3	74.1	(51.6)	(207.8)
Eastern	(335.4)	(852.3)	(136.5)	(35.6)	(252.8)	--
Midway	6.5	(21.7)	(22.9)	(11.4)	(18.7)	--
Northwest	162.8	355.2	(39.3)	59.6	90.7	--
Pan American	(118.3)	(414.7)	(184.7)	(46.9)	(25.8)	--
Southwest	57.4	71.4	5.1	23.5	23.0	(4.6)
Trans World	249.7	(298.5)	(143.0)	103.4	(14.7)	--
United	589.2	358.1	(35.7)	149.7	105.7	(123.5)
USAir	76.2	(137.7)	(66.9)	(24.7)	(111.1)	(221.1)
Total	1,196.0	(20.7)	(604.6)	514.6	(278.3)	(772.1)

[a] Full year data on net income (loss) for 1988 and 1989 were provided by the Air Transport Association (ATA) for its member and associate airlines.

[b] Data on net income (loss) for the first three quarters of 1990 were taken from the Form 41 data filed with the Department of Transportation.

[c] Data on net income (loss) for the fourth quarter of 1990 are taken from preliminary results provided by ATA for its member and associate airlines. Fourth quarter data are not yet available for all airlines. Total shown is for airlines that have reported so far. ATA projects the total loss for the fourth quarter to be approximately $1.7 billion and the total loss for 1990 to be at least $2 billion.

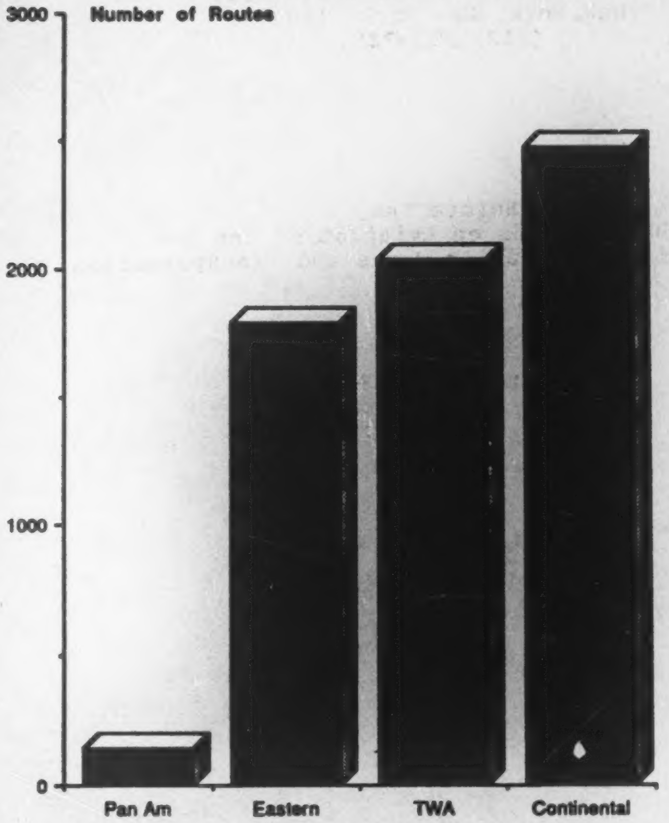
ATTACHMENT III ATTACHMENT III

U.S. MAJOR AIRLINES MARKET SHARE, CALENDAR YEAR 1990

Airline	Revenue passenger miles in thousands	Market share percent
American	76,998,599	17.467
United	75,945,637	17.228
Delta	58,983,900	13.380
Northwest	51,491,064	11.681
Continental	39,173,562	8.886
USAir	35,550,516	8.065
TWA	34,236,500	7.767
Pan American	30,676,000	6.959
Eastern	16,692,131	3.787
America West	11,114,444	2.521
Southwest	9,958,940	2.259

Source: Aviation Daily, January 23, 1991, p. 149.

ROUTES WHERE FINANCIALLY TROUBLED AIRLINES HAVE AT LEAST 10 PERCENT OF THE MARKET



Note: Represents the number of routes where the named airline had at least 10 percent of the market. The results are based on analysis of 17,645 routes using Data Base Products O&D Plus Data Base.

Eastern ceased operations on January 18, 1991.

Period: 3rd quarter 1989 through the 2nd quarter of 1990.

TESTIMONY

of

Brian Moreau, President
Independent Union of Flight Attendants
41 East 42nd Street, Suite 2300
New York, New York 10017
(212) 983-7250

Before The
Subcommittee on Aviation of the
House Committee on Public Works and Transportation

February 6, 1991

TESTIMONY

Mr. Chairman, and members of the Subcommittee on Aviation, my name is Brian Moreau. I am President of the Independent Union of Flight Attendants (IUFA). Our union represents the Flight Attendants of Pan Am, Pan Am Express and the Pan Am Shuttle. Thank you for the opportunity to testify before the Subcommittee on the current state of the airline industry.

As you are aware, all three carriers at which IUFA represents Flight Attendants are currently operating under Chapter 11 bankruptcy protection. Many of the questions being asked by this Subcommittee therefore can be answered by us in the past tense.

The Subcommittee asks if any major carriers are likely to fail or to sell major assets in order to survive. The answer regarding asset sales is clearly, "yes". Pan Am is surviving today solely as a result of major asset sales. It has sold its non-airline Inter-Continental Hotels and the Pan Am Building in New York. It has sold its Pacific airline division to United and its inter-German airline division to Lufthansa. Its Heathrow route authority is being sold to United and is the currently before the Department of Transportation for approval; issues related to the sale are being negotiated with the British authorities. The Pan Am Shuttle is on the auction block, and we have reason to believe that it will be sold in the near future. And as for the possibility of Pan Am's failure, at some point in the near future, Pan Am will have no more assets to sell, and the carrier may well be forced to cease its remaining operations.

The Subcommittee also asks if foreign carriers should be permitted to increase ownership in U.S. carriers. For the Flight Attendants at Pan Am, it would be a sad day for the United States flag bearer to be substantially owned and operated by a foreign concern. But it would be far sadder for the carrier to disappear into liquidation. Therefore, for our employees, we see increased foreign ownership as the lesser of evils.

The Subcommittee also asks, "What are the causes of the industry's financial difficulties and are these likely to continue in 1991 and 1992"? You have already heard of the effects of fuel prices and the effect of the Middle East situation on carriers. All of that is true. But I would like to take a minute to comment on remarks prepared by Secretary Skinner for presentation to the National Press Club on January 23rd of this year. Those remarks express Mr. Skinner's views on this general subject.

In his remarks, Secretary Skinner deals with the effects of deregulation in one paragraph, lumping together management's failure to adjust to deregulation, the taking on of massive and excessive debt, and a vague reference about the responsibility of the investment community. Yet he continues for nearly the rest of a page to berate labor and labor costs as the cause of airline woes.

What Mr. Skinner doesn't say is that the airlines with the lowest labor costs are the ones that have failed or that are in the worst financial shape. Surely, Mr. Skinner knows that the stronger carriers -- United, American, Delta and Northwest -- have wage scales and rates that for the most part are clearly higher than the employee costs of Braniff, People's Express and Air Florida, to name a few of the failed carriers. And he can't be referring to Continental and TWA, carriers with some of the lowest costs in the industry.

And most assuredly, he can't be referring to Pan Am. The Flight Attendants alone have either agreed to or had imposed on them concessionary contracts in the last three rounds of negotiations. We voluntarily agreed to 16 million dollar a year "givebacks" in 1982, we had a 50 to 60 million dollar a year concessionary package imposed on us in 1985, and in 1989, we voluntarily agreed to 32 million dollars a year in concessions. The other unionized employees at Pan Am have given similiar, or in some cases, greater concessions. We have given at the office, and our carrier has still gone bankrupt.

In Pan Am's case, Mr. Skinner neglects to recall that it was the U.S. government that prohibited Pan Am from operating a single route within the United States for nearly 50 years. Pan Am effectively was forced to build its hubs overseas. Concurrently with the adoption of domestic deregulation, the government began awarding routes from more internal U.S. cities to foreign destinations. More often than not, the awards went to those U.S. carriers with already established domestic hubs, for example, Delta in Atlanta and USAir in Pittsburgh. Pan Am, having been kept from domestic U.S. operations for so many years, was at a distinct competitive disadvantage.

The Department of Transportation next began to allow foreign carriers greater access from their foreign hubs to destinations within the United States. And now, the possibility of cabotage -- the right of foreign carriers to fly within the United States -- is being debated. If cabotage is approved, and foreign carriers are able to operate with foreign crews within the United States, U.S. based flight attendants may face our greatest challenge. Envision, for example, a Mexicana hub in Houston, with pilots and flight attendants being paid the prevailing wage in Mexico. It will only be a matter of time before U.S. carriers demand that their U.S. employees lower their wage rates to compete.

While there is some evidence that consumers might enjoy some benefits from these government actions, Congress and the

Administration nevertheless should acknowledge the direct effect such government actions have had, and continue to have, on U.S. carriers, and specifically our carriers -- Pan Am and its employees.

The Subcommittee has asked if financially weak carriers should be allowed to sell international routes. It is unfortunate that at Pan Am, our continued survival may require that such sales be allowed. Pan Am tells its employees, with reason, that the cash it receives from United, as well as the proceeds from the sale of the Shuttle, will be required to continue operations. We do not want to see our carrier sold off in pieces. We take great pride in working for Pan Am. Yet we face the possibility of the total loss of employment if these sales are not allowed. However, we should not forget that when there are only a few mega-carriers left, which appears to be more likely with each passing day, the consumer will begin to bear some of the burden that employees have so far carried alone.

I would like to conclude by reporting to you on the effects of international route sales on the employees at Pan Am. The Department of Transportation has refused to consider the effects of such sales on our employees. The Department has said that unions must negotiate directly with their carriers to alleviate the detrimental effects of mergers, route sales and Department of Transportation decisions.

Let me tell you what that means in the real world. It means that thousands of airline employees have already lost their jobs and thousands more will follow. The Department does not tell us how we can negotiate with United Airlines over the effects of its purchase of our London routes. It takes approximately 700 Flight Attendants to operate a full summer schedule of flights into Heathrow. How do we negotiate with United when we have no legal entitlement to do so? Indeed, the Association of Flight Attendants (AFA) has the exclusive statutory right to bargain with United on behalf of flight attendants employed by that carrier. We have no such right. So, in the meantime, 400 London-based Pan Am Flight Attendants and 102 Washington-based Pan Am Flight Attendants have just this week been given furlough notices. United says that it may offer employment to some London Flight Attendants, but only at entry level wages with zero seniority. How are we to "negotiate" something different with United?

Next, the Department of Transportation tells us to negotiate with our individual carriers for protections. We did. We negotiated what is called in the industry a "SCOPE" clause. Here are the results of our agreement.

One portion of our SCOPE clause says that all flying performed by Pan Am Corporation will be done by our members. No sooner had the ink dried on the agreement than the Company began court challenges to stop our efforts to enforce it. So far, we have been able to arbitrate only one of many job assignment disputes, because most courts have ruled that our agreement is unenforceable -- not that the Company didn't agree to job protections -- simply that the agreements themselves could not be enforced either through arbitration or through the courts. And most recently, one appellate court has ruled that the provisions of the Railway Labor Act do not apply to foreign point to foreign point flying, and therefore, that our SCOPE clause in essence is unenforceable as to that flying. For a workforce which has done foreign flying almost exclusively, it is startling to be told by the courts after 60 years that our contract can't be enforced.

For our protection, we also negotiated the requirement that Pan Am give 60 days' notice of base closures. Our London base is being closed with just over 30 days' notice. We will now have to fight for enforcement of those negotiated benefits -- again.

And our final negotiated job protection -- the payment of enhanced severance pay in the event of furloughs resulting from routes sales -- has been weakened substantially by Pan Am's bankruptcy filing. After a three-year process, an arbitrator finally ruled that Pan Am was required to pay "SCOPE" severance pay to our Flight Attendants who were furloughed in San Francisco as a result of the sale of the Pacific division to United. Apparently, Pan Am considers those monies to be a "pre-petition" bankruptcy claim, and we will now have to fight in the bankruptcy court to recover those negotiated job protections.

Secretary Skinner, in his remarks to the National Press Club, cited labor costs as detrimental to the industry. From our perspective, it appears that the Department is doing its best to help the carriers achieve lower labor costs. Without fail, it has steadfastly refused to impose even the most minimal Labor Protective Provisions in route sale cases, even though it has the ability -- if not the obligation -- to do so. The results have been that the more senior employees, the employees who have spent most of their working lives establishing the very routes that are being sold or transferred, are out of a job.

The acquiring carriers then come in and employ new hires to operate the same flying at substantially reduced wages, with reduced benefits. But, of course, this applies only to American workers. United is protecting the jobs of British ground employees in its purchase of our Heathrow authority. It is even planning to advertise for local English employees to fill some Flight Attendant positions in London. American Airlines offered employment to all South American-based employees, including foreign Flight Attendants, when it took over Eastern's Latin American routes. Foreign employees continue to work for U.S. carriers. Only U.S.-based employees have lost their jobs. Is this considered in the public interest?

Department of Transportation negotiators are fighting Pan Am's and United's battles with the British, apparently ready to make major concessions for approval of the Heathrow transfer. United's Chairman has even met with Vice-President Dan Quayle in an effort to smoothe the approval of the transaction. We could only wish that the United States government would give similar consideration to our employees.

We ask that this Subcommittee, and other Committees of Congress, look seriously at the effects that deregulation, route sales and Department of Transportation decisions are having on the United States workforce. Strong airlines will become stronger; weak airlines will become weaker. Some consumers may see temporary gains. But the employees of the U.S. carriers will again be left without protections, and without jobs.

Once again, I appreciate the opportunity to testify here today. Thank you.

UNITED STATES HOUSE OF REPRESENTATIVES
Committee on
PUBLIC WORKS AND TRANSPORTATION
Subcommittee on
AVIATION

"THE CAPITAL CRISIS IN THE U.S. AIRLINE INDUSTRY"

PREPARED TESTIMONY
Submitted by

TIMOTHY PETTEE
Vice President
Alliance Capital Management

Wednesday, February 6, 1991

EXECUTIVE SUMMARY

The U.S. airline industry is on the verge of a capital crisis, which if not addressed could severely curtail competition. This capital crisis, characterized by rising costs of debt, lease and equity financing, would at the least weaken the financial condition of some of the nation's strongest carriers and at the most choke off investment in some of the nation's weaker carriers, leading to their inability to sustain operations. Already the competitive landscape of the airline industry has been altered by Eastern Air Lines' inability to attract investment capital of any sort, leading to its cessation of operations and liquidation. A similar fate awaits Pan American World Airways if it is unable to attract significant sums of debt and equity financing in the near term. Without access to reasonably priced capital, the U.S. airline industry will be unable to upgrade its fleet and facilities such as gates, terminals and maintenance operations. Expansion among the strong carriers would be curtailed and industry growth would stagnate at best. Weaker carriers will undoubtedly fail. In short, without access to reasonably priced capital, competition will be curtailed immeasurably in the U.S. airline industry to the detriment of the consumer.

The rise in costs of capital, and for some carriers, inability to access airfinance capital markets is in part a function of conditions in the commercial lending industry and the general state of the economy. As capital markets tightened in the late 1980s, the airline industry was buffeted by softening demand, and since the mid summer invasion of Kuwait by Iraq, an unprecedented rise in fuel costs, which had comprised approximately 15% of the industry's costs. Since the outbreak of war in the Persian Gulf, traffic has declined at an unprecedented rate, further straining the financial condition of the nation's airlines.

Contributing to the capital crisis are factors unique to the airline industry. Among these factors is the historical low rate of return airlines have earned. Expectations of the airline industry earning an average margin and/or rate of return are generally not enhanced by a frequently critical general media and short term orientation of many within the financial community. Also unique to the airline industry is the high rate of default incurred in the several billion dollars of high yield, or junk, bonds in airline issuers sold in the 1980s. Further eroding airfinance markets confidence has been the abuse, in my opinion, of the bankruptcy code. Creditors in one major airline bankruptcy were unable to recapture assets they were legally, under the bankruptcy code, entitled to recapture, and in another, were depleted of nearly all funds in a failed reorganization attempt managed in the "public interest," irrespective of the interests of the estate and its debt and equity holders.

The U.S. airline industry has an estimated $80 billion in aircraft orders backlogged with the world's major commercial aircraft manufacturers. Costs of ownership of such aircraft, including depreciation, amortization and interest costs for owned and leased equipment, comprise approximately 15% - 20% of the industry's costs, more than even fuel. Traditional sources of financing in the airline industry have included short and long term debt, operating leases, long term leveraged leases and equity. Each of these sources of capital for airlines is rising in cost. More liquid short term debt markets have been difficult to access for some air carriers and long term debt markets have experienced a rise of as much as 150 basis points over the traditional spread between such capital and treasury notes. Operating lease markets have been hampered by the sharp decline in the values and residual value assumptions of older aircraft and the speculative activity in newer aircraft markets. The long term leveraged lease market, one of the most popular forms of financing in the 1980s has been hurt by the rising costs of debt capital and lower demand for the equity portion of such leases by corporate buyers. And the costs of equity capital have risen sharply due in part to the decline in value of most airline equities and the unsuccessful experience of foreign buyers of U.S. airline equities.

As a result, I respectfully urge the Federal government to take legislative and/or administrative steps designed to enhance investment incentives in the U.S. airline industry. Such investment incentives, in so far as their ability to attract capital to the industry would serve to enhance competition within the industry. Legislative and/or administrative actions which would serve to enhance investment incentives in the airline industry include allowing increased foreign ownership and control of U.S. carriers, reinstituting investment tax credits or other equipment investment incentives to enhance U.S. airlines ability to upgrade their fleet, and further strengthen the U.S. bankruptcy code to offer greater protection to creditors and investors from abuses and inconsistencies put forth by bankruptcy courts.

FACTORS CONTRIBUTING TO THE CAPITAL CRISIS IN THE INDUSTRY

The capital crisis in the airline industry is in part a function of the general business conditions in the banking and financial industries as well as the extraordinary swings in airline operating costs and traffic recently. Commercial banks, long a source of capital to airlines, have been beset by losses in commercial loans to developing countries, real estate industries and excessively leveraged entities which has served to tighten available credit in other areas. Similarly, investment banking and brokerage companies, a source of debt and equity capital, have reduced their scope of operations and distribution capabilities in the face of a downturn in their businesses. Amidst this environment in the

U.S., alternative sources of capital have not materialized. In overseas capital markets, particularly Japan, the extent of capital made available to U.S. airlines has declined amidst declines in the values of world stock markets and real estate and generally soft economic conditions in developed economies.

These macroeconomic conditions, which materialized in the late 1980s, have been compounded by violent swings in costs and revenues in the airline industry. The spike in fuel costs in the winter of 1989-90 produced record losses in the 1990 first quarter of over $500 million. With the economy slowing, airline traffic weakened in mid 1990. Then, fuel prices soared to over $1.20 per gallon in the autumn of 1990 after the invasion of Kuwait by Iraq. This represented almost a 100% increase in fuel costs for the U.S. airline industry, prompting record losses of approximately $1 billion in the fourth quarter of the year and nearly $2 billion for 1990 as a whole. Amidst the violent increase in fuel costs, Continental Airlines filed Chapter 11 protection in December and Pan Am did the same in January 1991.

More recently, following the outbreak of war in the Persian Gulf, airline traffic, particularly but not limited to transatlantic markets, has declined in an unprecedented fashion. Airline companies have reported transatlantic load factors, or the percentage of seats filled, have fallen from approximately 50% - 60%, to approximately 30%, representing a huge swing in an industry known for its operating leverage. Furthermore, a large portion of the lost traffic has been comprised of higher yielding business travellers, many of whom have postponed or cancelled travel plans. Perhaps more importantly, the concerns of travellers has come at the beginning of the summer booking season. Continued softness in bookings could have a devastating impact on many airlines peak summer traffic expectations. It appears other carriers, such as Pan American, will not be able to sustain operations even with a level of capital investment as a result of the severe market and operating conditions likely this winter and spring.

In addition to the above noted conditions, there are several factors unique to the airline industry contributing to the looming capital crisis, including the historically poor rates of return earned by the industry, the default of approximately 75% of the junk bond debt raised by the airline industry, and the abuse of the bankruptcy code, not by debtors, but by the courts.

With respect to rates of return, the airline industry is unique in that it is both capital and labor intensive. In 1988, the airline industry recorded operating profits of more than $2.5 billion, the most ever in a single year. However, this equated to just a 5% margin and 8% return on assets, well below average U.S. industries returns. Historic rates of return have been depressed by a variety of factors including the cyclical nature of traffic and hence revenues, swings in interest rates and fuel prices as well as the high costs of labor in the industry. Expectations of improving rates of return in the airline industry are held to a minimum by an ever-critical general media which frequently assails the airline industry for its reservations and pricing practices, despite repeated studies by dependent and independent researchers that have concluded the industry is extremely price competitive. Further dampening expectations of improving rates of return in the industry is the short term orientation of the debt and equity capital markets in the airline industry, due to the seasonal and cyclical nature of the industry.

Also unique to the airline industry and contributing to the capital crisis has been the high rate of default in airline high yield, or junk, bonds. In the 1980s, the airline industry raised approximately $3 billion of high yield bonds. Certain of these bonds were used to finance start up carriers, such as People Express. Even with the high coupons attached to these instruments, the influx of capital they represented significantly increased competitive forces in the airline industry. While the junk bond phenomenon of the 1980s has been met with a high rate of default among issuers, no industry has seen as high a default rate than the airline industry, where approximately 75% of the issues have defaulted and/or been restructured from their original terms. This has had a tremendous influence on the ability of weaker airline credits to raise debt at any price. While such capital did enhance competition, the high yield debt was an extremely poor use of capital for the industry and only prolonged the consolidation of the airline industry underway today.

An additional factor unique to the airline industry and contributing to its capital problems has been the mismanagement, in my opinion, of the bankruptcy code and process by at least two courts in which airline bankruptcies were conducted. The uncertainties resulting from these problems has served to undermine the confidence of airline industry creditors and potential lenders and financiers. The first such case was in the 1989 bankruptcy of Braniff Inc. After filing bankruptcy, and subsequently failing to reaffirm within 60 days certain obligations subject to Section 1110 of the bankruptcy code, the court prevented creditors from seizing the assets covered by Section 1110 of the code. The court cited the interests of the estate and its attempts to reorganize. While these assets were subsequently released and Braniff eventually liquidated, the court's action ran contrary to the provisions of the code which are designed to protect assets of creditors and severely undermined the confidence of domestic and foreign lenders in the airfinance capital markets.

The second airline bankruptcy undermining the capital markets was that of Eastern, which recently abandoned its attempts to reorganize and is in the process of liquidating. Despite repeated calls by creditors to scale back the scope of the reorganization and then liquidate, the court ruled that it was in the "public interest" to disregard these inputs and instead allowed the expenditure of funds earmarked for creditors. While the bankruptcy code is designed to protect the debtor from creditors, the inclusion of the "public interest" substantially subordinated the interests of secured and unsecured creditors and provided in effect a series of subsidies by the court to Eastern, significantly impacting the financial condition of other carriers. I am of the opinion the public interest was ill served and should not have been as significant a factor in the attempted reorganization of Eastern. Again the confidence of lenders and creditors was undermined in this mismanagement of the bankruptcy process.

STATE OF AIRLINE INDUSTRY CAPITAL MARKETS

The U.S. airline industry is in a precarious position: The industry has approximately $80 billion in orders for new aircraft necessary to upgrade and re-equip the fleet. That is two to three times the total invested capital in the airline industry today. With operating results severely impacted by external and other variables and with recent legislation mandating older noisier equipment be phased out of service, How is the industry going to finance the necessary upgrade of its fleet and facilities? The answer is with a variety of debt, lease and equity capital as the industry has done in past periods of re-equipping. However, continued excessive rises in costs or deterioration in revenues, and/or a sharp and sustained rise in interest rates, could shut off even the strongest carriers access to these forms of capital, leading to more airline failures, consolidation and a reduction of competition.

Debt has been the most prevalent form of financing in the capital intensive and leveraged airline industry. Airlines have used short term debt markets and commercial paper to enhance liquidity and cash management techniques and have long used long term debt markets to finance equipment. However with the recent unprecedented losses, certain major U.S. air carriers have had some difficulty accessing short term debt and commercial paper markets. This could lead to a liquidity crisis at some carriers which would necessitate a Chapter 11 filing and additional near term sources of capital to sustain operations if current operating trends continue. As for long term debt markets, the spread over treasury notes accorded such capital has risen as much as 100 to 150 basis points for the airline industry since mid 1990, amounting to an incremental $40 million per year in interest costs to the airline industry.

Lease capital has been one of the most popular forms of financing in recent years due in part to the strong demand of such instruments as a result of the repeal of the investment tax credit and due in part to the off-balance sheet nature of this capital. In the short term operating lease market, the driving force has been residual value assumptions--the estimated value of the aircraft or related asset at the end of the lease term. Residual values for aircraft and related equipment have remained at levels high enough to provide significant ongoing economic benefit in the asset. However, recently as a result of the diminished economic usefulness of many older aircraft amidst the poor operating environment and the enactment of noise legislation, values of used aircraft and residual value assumptions have fallen dramatically, impacting the operating lease market for new and used aircraft. Several large operating lease companies dominate the market for such financing, however their costs of capital are rising in part due to the forces noted above and due to excessive ordering and speculation in new aircraft by certain of these institutions.

The leveraged lease market was the most prevalent form of financing new aircraft in the 1980s. These long term financings, which for accounting convention remain off-balance sheet, are comprised of two facets: the debt covering approximately 70% of the value of the asset and the equity, covering the remaining 30%. The debt portion of such leases is supplied by traditional lenders to the airline industry. The equity portion of the leveraged leases is typically provided by corporations and their affiliated companies who sought to purchase the equity and related tax benefits of such financings to shelter or offset taxes on earnings. Thus the driver for the equity portion of these financings and hence the driver for the whole transaction is corporate profits. When corporate profits were up, the demand for such instruments was high. With corporate profits down, the demand for the equity portion of these transactions has fallen off sharply. A sustained recession in which corporate profits remain under pressure would severely curtail this form of asset financing for the airline industry.

With the overall deleveraging trend going on in the capital markets today, airlines are likely to increasingly look to equity financing, both foreign and domestic, to meet the capital requirements of the 1990s. During the 1980s, established U.S. airlines used equity financing sparingly as the relative costs of capital favored debt and/or leasing markets (an exception to this was among new entrant airlines which used equity financing extensively to launch and build operations). As earnings have fallen dramatically, following the leveraging of many airline balance sheets in the 1980s, the debt rating agencies are looking keenly at the ratings of most airline companies with an eye toward lowering their ratings to reflect increased costs of capital, higher risks associated with the obligations and the large capital spending planned in the early 1990s. To stem deterioration in financial condition, airlines and indeed corporations across the country are looking to investors for additional equity capital to shore up balance sheet ratios and enhance working capital. However, with the overall decline in equity markets of late, the relative costs of these equity financings is high as they potentially dilute existing shareholders.

The trend toward U.S. airlines seeking foreign equity capital has likely ceased pending a significant reversal in the U.S. industries performance and/or a change in the Federal law limiting control and ownership positions. The underlying returns on investment by foreign airlines in the U.S. carriers have been remarkably poor. Ansett of Australia has lost more than 50% of the value of its more than 10% ownership position in Phoenix based America West Airlines. Scandinavian Airlines Systems investment in 17% of Continental Holdings Inc. common stock has been reduced by more than 90%, including the effects of currency changes on their investment. And KLM Royal Dutch Airlines, has posted a significant decline in the value of their holdings in the parent company of Northwest Airlines. Only Delta's partners Singapore Airlines and Swissair, both of which own 5% of Delta's common stock, have not experienced signficant write-downs of their investments.

PROPOSED FEDERAL GOVERNMENT INITIATIVES

The most competitive industries in the United States are those in which capital flows freely and is available at reasonable rates. Airline competition flourished during the early to mid 1980s when just such conditions existed. As such I would not recommend any "reregulation" of airline service, rates and/or federally mandated net worth or other financial tests. Instead, I would recommend Federal legislative and/or administrative initiatives designed to enhance and attract capital investment in the airline industry. Such measures, outlined below, would ensure the U.S. airline industry is financially capable of upgrading its fleet and facilities, and would promote competition in domestic and international markets alike.

On the issue of foreign ownership of U.S. airlines, the Secretary of Transportation's recent policy initiative to define the meaning of "control" as up to 49% of the equity capital falls short of its intended mark and is not likely to have any measurable impact on the industry other than to allow KLM to retain its investment in Northwest Airlines. I recommend the U.S. repeal the law limiting control of U.S. airlines by foreign citizens. If foreign equity capital is to be attracted to the U.S. airline industry, the definition of control must be relaxed further. Based on the poor experience of foreign investment in U.S. carriers to date, foreign investors will likely not make additional investments without some ability to exert control or have "significant influence" on a company's direction.

The biggest objection to allowing foreign control of a U.S. carrier appears to be in the area of national security interest, such as with respect to the subject carrier's participation in programs such as C.R.A.F. However, it may be possible to prohibit foreign citizens from voting on corporate issues of national security interest and still attract foreign equity capital.

With respect to debt capital, government must in my opinion provide incentives to invest in the U.S. airfinance industry or risk having the industry unable to re-equip the aging fleet and infrastructure. Enhanced depreciation allowances on jet aircraft and investment tax credits on purchased aircraft could have the effect of broadening the market and lowering the costs of capital for such investment.

Lastly, the U.S. bankruptcy code needs to be overhauled further in order to prevent inconsistent application of the code and allow for further protection of creditors assets and recourse amidst the reorganization process.

BIOGRAPHICAL INFORMATION

Timothy Pettee is a vice president with Alliance Capital Management Co., a New York based pension an mutual fund manager with approximately $45 billion under management. Mr. Pettee is a research analyst responsible for transportation and aerospace/defense industry equity investments. Prior to joining Alliance Capital in 1990, Mr. Pettee was associated with Merrill Lynch & Co., Bear Stearns & Co., and L. F. Rothschild & Co as an airline industry analyst. In addition, Mr. Pettee served as Manager of Investor Relations for Texas Air Corporation from 1981 to 1984. Mr. Pettee was previously affiliated with Standard & Poor's Corporation as a generalist in the equity research department.

Mr. Pettee holds a Bachelor of Arts Degree in Economics from Boston University. He is a member of the New York Society of Security Analysts and is President of the Society of Airline Analysts.

ADDITIONS TO THE RECORD

AmericanAirlines

WILLIAM J. BURHOP
VICE PRESIDENT
FEDERAL AFFAIRS

March 19, 1991

The Honorable William F. Clinger, Jr.
U.S. House of Representatives
2160 Rayburn Building
Washington, DC 20515

Dear Congressman Clinger:

As a result of the significant financial investments in the development and operation of a computerized reservation system (CRS), American Airlines is concerned about any proposed legislative or regulatory changes that could affect these investments and the competitiveness of the CRS industry. Changes in the laws or regulations applicable to CRSs must be examined carefully, especially in light of recent changes in the airline industry in general and the CRS industry in particular.

During the ongoing public debate on this issue, many misconceptions about CRS have surfaced. For example, during the February 6, 1991 House Aviation Subcommittee hearing, a GAO official stated that due to a "lack of effective competition in the computer reservation services (CRS) industry," American and United each "receive [from its CRS] over $300 million per year in excess of the cost of the service provided (including a reasonable profit) from other carriers in the industry, most of which are financially weaker." This statement is not accurate, therefore, we request that this letter of explanation be included in the official transcript of the Subcommittee's proceedings.

GAO's statement fails to recognize the following: First, contrary to the premise of the GAO testimony, the CRS business is hotly competitive as evidenced by the major changes in marketshare in the industry in recent years. The American and United systems were launched years ahead of the other CRS systems and, as a consequence, -- SABRE and Apollo -- were the largest at the beginning of the 1980's. However, due to vigorous competition, SABRE's and Apollo's respective shares of travel agency locations have fallen appreciably during the past several years. Significantly, Apollo has now been displaced as number two in the industry by Worldspan -- the system owned by Delta, Northwest and TWA.

Second, the conclusion that American has received _excess_ profits from other carriers of more than $300 million annually is without foundation. The _total_ profit which American derived from SABRE's worldwide operations in 1990 (encompassing over 15,000 travel agent users in over 45 countries) was $77.7 million after tax. This figure reflects payments made by all carriers, to SABRE including American. Even this $77.5 million profit is substantially offset by the $57 million in booking fees which American paid to other CRS vendors in 1990. In short, revenue transfers from other carriers to American are not sufficient to have any appreciable effect on airline competition.

Third, the GAO statement was based on 1986 data. While we disagree with GAO's conclusions for 1986, we are even more concerned about using old data to comment on current competitive conditions in the industry. As a result of the major changes in the CRS industry and its technology, any further analysis of CRS policy must be based on more current data.

Fourth, any suggestion that financially weaker carriers subsidize American's operation is untrue. The profits which American derives from the CRS business are not sufficient to have any appreciable impact on airline competition. A single wide-bodied aircraft costs far more than SABRE's annual profit of $77.5 million. Nor does American realize from carriers such as America West any enormous transfer to fund American's airline operations. In 1990, America West -- a company with more than $1 billion in revenue -- paid SABRE a _total_ of $10,445,000 in booking fees, leaving American a post-tax contribution of $1,400,000 from that one carrier. Payments from other small carriers, such as Midway and Alaska Air, are about 30% of the amount paid by America West. These amounts should not have any impact on the carrier making the payment.

The GAO statement is just one of the instances in which the CRS business has been unduly criticized. CRSs do not impair airline competition, as some have claimed. In fact, CRSs facilitate market entry or expansion because new flights are instantly available for sale through tens of thousands of computer terminals across the U.S. and the globe. This phenomenon is illustrated by the rapid growth of smaller airlines which do not own CRSs. Additionally, by allowing carriers to quickly announce and promote new fares and by providing means for travel agencies to easily find the lowest rate, CRSs have fostered a level of fare competition which would have been impossible without automation.

CRSs have been a rare success story for U.S. industry. U.S. systems have so far surpassed their competitors that, across the globe, foreign carriers have pooled their resources in an effort to develop comparable systems. They have done so with the active support of their governments. The European Community, for example, has offered low-cost financing to at least one of the two European systems. At the same time, fees charged by foreign CRS vendors are appreciably higher than fees charged in the U.S. Additional regulatory burdens could cede this high-tech industry to foreign companies.

We believe that any discussion of legislative or regulatory proposals for CRS must be based on the most accurate and up-to-date information available. For that purpose, we are prepared to meet with you and your staff at the earliest opportunity to provide a full briefing on the facts concerning this vibrant industry and on the potentially negative economic and competitive impact that certain regulatory proposals under consideration would cause.

Sincerely,

William J Bishop

/ch

ASTA

American Society of Travel Agents

P.O. Box 23992, Washington, DC 20026-3992
1101 King Street, Alexandria, VA 22314 USA
(703) 739-2782 • Telex 440203 • FAX (703) 684-8319

February 13, 1991

The Honorable James L. Oberstar
Chairman
Subcommittee on Aviation
2251 Rayburn House Office Building
U.S. House of Representatives
Washington, D.C. 20515-6527

Dear Mr. Oberstar:

ASTA appreciates your calling the hearings on the financial condition of the airline industry. The problems besetting the airlines are widely reported and signify a real threat to a vital national resource. Not only are two active carriers currently in bankruptcy, but financial reports in the media suggest that others may soon follow. Our principals in the airline business often complain that bankruptcy procedures are at least partially responsible for the present condition of the industry, in that the pricing practices of the bankrupt carriers make it impossible for the other carriers to charge profitable prices for their services. Short of price controls, which no one supports, we have no quick or easy solutions to the ills that prevail in the industry today.

The airline industry has the advantage of one of the lowest cost distribution systems in the American economic system. All airlines use the same travel agents to sell their services, and travel agents account for about 80 percent of all airline sales. The standard commission paid is a mere ten percent of the ticket price, which commission rate has remained constant for many years in spite of added work performed by agents including making seat assignments and issuing boarding passes. Because the commission is based on the ticket price, compensation of travel agents fluctuates with the constantly changing pricing actions of the airlines.

Thus, when an airline has a "sale", and does not restrict the sale price to new purchasers, many passengers return to their agents to rebook their previous reservations at the new, lower price. The airlines thus may attract some new business through the sale, but the yield from many previous transactions at higher prices is also reduced. And, of course, the travel agent is billed by the airlines for the difference in commissions on those rebooked transactions, thereby reducing the agents' income for doing double the work.

We do not suggest that the Congress can do anything about the severe impact that these practices have on travel agents. But the practice of the airlines to reduce revenues on previously sold tickets when trying to promote new business has, in ASTA's view, been a major contributor to the decline in airline yields during the period of intense price cutting that preceded and followed the fuel price crisis in 1990. The recent and highly publicized companion fare "two for one" sale is a classic example of the problem. When the public learned of this sale, many, many travel agency clients and also direct-purchasers from the airlines returned with their previously issued tickets to take advantage of the sale, thereby converting two paid tickets into one paid ticket effectively covering two passengers.

In a related vein, rebating of air fares below tariff rates is rampant in international markets. A travel agency subsidiary of one foreign airline is offering corporate customers an across-the-board rebate of 28 percent on international fares! Such rebating is unlawful under the Federal Aviation Act, but the Department of Transportation has stated that it will not enforce the law because it regards rebating as healthy competition that benefits consumers. While consumers are, in one sense, benefited by lower prices, the long run effects of rebating on carrier revenues contribute to the debilitating downward economic spiral in which the industry is now stuck. Consumers will surely not benefit if the efforts of current irrational airline pricing practices succeed in destroying additional airlines.

The Committee should consider exploring these self-destructive airline pricing practices with the airlines and the Department of Transportation to evaluate the contribution they have made to the current industry crisis and what plans the airlines have to remedy the situation.

As stated earlier, ASTA has no simple solutions to offer that will cure the airlines' ills overnight. Our legislative focus, therefore, is on the other side of the equation. What protection exists for the public if there are more airline failures? A horrendous nightmare has just been averted in the Eastern Airlines shutdown because Eastern had, at ASTA's urging, established a passenger protection fund to cover refunds. No other carrier has such a plan and the public is exposed to huge losses if another carrier shuts its doors.

ASTA is extremely concerned that should such an event occur there is no procedure in place to provide refunds or alternative means of travel. The ticket holder, your constituent, will simply be out the money and will have to stand in line with all the other creditors. It could be years before any monies would be received by the ticket holder if indeed funds for this purpose remained after a liquidation.

ASTA, with the support of the Consumer Federation of America, has been in the forefront in the effort to get the Administration and the Congress to focus on this serious flaw in our transportation system. To date our effort has been in vain. Although Congressman Boehlert and Senator Kassebaum have faithfully placed a bill to address this need before the Congress every session, they are unable to gain the support of House and Senate Aviation Committees. Consequently, the legislation has never become law. Clearly there is a need for this problem to be addressed.

ASTA has also been in the forefront in calling for changes in the current airline owned CRS systems. At present the two largest carriers own the CRS systems through which the major portion of all tickets for air travel are booked by the travel agents.

ASTA feels that if we are going to maintain competition within the CRS market we must remove three major barriers: (1) CRS contract provisions related to duration of contracts and booking practices, (2) misuse of agents' proprietary data, and (3) deterrents to use of generic computer equipment and interconnection of the CRS systems. ASTA has recommended that the Department issue a proposed rule that would effect the following changes in current law:

1) impose a maximum three year term on CRS contracts with travel agents,

2) require that CRS vendors offer alternative contract periods for add-on leases with prices reasonably related to the choices available,

3) prohibit minimum use clauses and parity practices,

4) prohibit liquidated damages clauses based on booking fees,

5) prohibit vendors from extracting, for any purpose, agent sales data related to other airlines,

6) require the vendors to permit interconnection of their databases through generic computer equipment, and

7) require continuous monitoring of CRS contract practices.

8) permit private enforcement of the regulations through lawsuits in the courts.

ASTA has filed two petitions, one in 1987 and again in 1989, asking the Department of Transportation to address these concerns and issue a new rule. To date the Department has not acted even though the Chairman and several members of the House Aviation Committee have requested they do so.

ASTA strongly feels until the problems and unfairness existing in the present CRS systems are rectified, we will not attain true competitiveness in this industry. Nor will there be any new entrants in the CRS or airline industries of significant stature to assure the competitiveness we need if the traveling public is to be properly served.

On behalf of your travel agent constituents and all agents throughout America, I am asking you to please write Secretary of Transportation, Samuel Skinner requesting him to issue the new rulemaking on CRS regulations and to co-sponsor H.R. 66, the Airline Bankruptcy Passenger Protection Act. I look forward to your response to these requests.

Sincerely,

Philip G. Davidoff, CTC
President and Chief
Executive Officer

MARION KINDIG
President - R. O. B.
P. O. Box 15503
Washington, D. C. 20003
(202) 544-1400

February 6, 1991

The Honorable James L. Oberstar
and the Subcommittee on Aviation
House of Representatives
2209 RHOB
Washington, D. C. 20015

FOR THE RECORD RE HEARING CONCERNING COMPETITION IN THE AIRLINE INDUSTRY, DATED February 6, 1991

To the Honorable Members of the Aviation Subcommittee:

During yesterday's hearing, February 5, 1991, Secretary Skinner of the Department of Transportation testified before your Committee that Discovery Airlines had filed false statements with the DOT, and further testified that they "tried to blow one by me". It needs to be brought to the Committee's attention that there are other larger airlines which have, in fact, "blown one by Secretary Skinner", and he has as of this date taken no action and does not appear to be inclined to do so.

When United Airlines applied to the DOT for the purchase of Pan Am's Pacific routes, it gave written statements, verbal assurances and sworn testimony to the DOT as to the manner in which it would hire Pan Am Employees. United made these same verbal and written statements to the Pan Am employees. See Exhibit 1, with attached Exhibits A, B, C, D, E, F, G, H, I, J, K, L, M, N and O. After the DOT granted the Pacific route sale, United proceeded to blatantly breach and violate those written, verbal and sworn representations, whereby contrary to the agreements United had made to hire by seniority and base, it hired the most junior personnel at the lowest salary, contrary to what it had represented. Although the DOT relied upon United's representations in granting the Pacific Route transfer, United later testified that it is not bound by any commitments it made to the DOT. United further stated in sworn testimony that it is similarly not bound by any commitments which it had made to the Pan Am employees.

THE $800 MILLION FRAUD

Starting in approximately 1980, Pan Am proceeded to systematically plunder its employee pension funds, in an amount which is now estimated by the PBGC to be at $800 million. On January 8, 1991, Pan Am declared Chapter 11, and dumped its $800 pension liability into the lap of the PBGC. The major problem with this is that the PBGC is itself woefully underfunded, with the nation's underfunded pension plans amounting to $40 billion in the aggregate. Former Inspector General of the DOL, Mr. Raymond Maria, has warned that the nation's pension funds, worth some $1.6 trillion in the aggregate, have been "looted by fraud and abuse that will dwarf the savings-and-loan scandal when it comes to light".

FURTHER FALSE STATEMENTS MADE TO THE DOT BY UNITED AND PAN AM

In the Joint Answer to Objections to Order 91-1-11 filed by United and Pan Am on January 22, 1991, in the London Route transfer case, United and Pan Am attempted to create a false sense of urgency stating that the DOT must issue its final approval of the London route transfer on January 25, 1991, stating "However, for Pan Am to borrow additional funds on that date, the Department also must have issued a final order approving the United/Pan route transfer. Pan Am's ability to draw down additional funds is critical to its continued operations." Pan Am's ability to continue operations beyond that January 25 is, therefore, directly linked to its ability to borrow additional sums from Bankers Trust."

What United and Pan Am studiously prevented the DOT from being made aware of is that the Pension Benefit Guaranty Corporation had contacted three major financial institutions, each of which is recognized as a leader in providing DIP financing -- and Pan Am was so desperate for cash that it never bothered contacting any of the three institutions. (See attached as Exhibit 2 the PBGC's brief filed on January 10, 1991, in the Pan Am bankruptcy proceedings, Page 5.) In the PBGC's objections to the sale of the London routes to United, it further stated:

> "The PBGC objects to the Debtors' linking of DIP financing with the UAL Agreement to create an artificial emergency. Further, there is no showing before this Court that such a linkage is in the best interest of Debtors, their estates and their creditors "
>
> "Debtors make no demonstration whatsoever in their motion that the extraordinary authorization to sell the London Routes to UAL, without offering that opportunity to others in an open bidding procedure, is appropriate."
>
> "As reported in a Wall Street Journal article on October 29, 1990, page B1, American Airlines proposed to offer Pan Am $200 million more for the London Routes than the cash price in the UAL Agreement, but was precluded from pursuing that transaction by the existence of the "lock" provisions of the UAL Agreement."
>
> "Recent events point to a conclusion that the purchase price in the UAL Agreement is too low. Clearly, the "lock up" provisions of the UAL Agreement should have no effect in this bankruptcy case".

> "PBGC believes that a sale of the London Routes on the terms of the UAL Agreement may jeopardize the ultimate goal of successful reorganization of Debtor's business ... With the loss of these routes at the commencement of its Chapter 11 case, Airways will substantially reduce its attractiveness to prospective business partners."

> "Debtors have not indicated to the Court that they contacted anyone about DIP financing other than Bankers Trust. The institutions contacted by the PBGC further indicated that such financing might not be contingent on approval of the sale of the London routes to UAL."

> "Smith Barney, the financial advisor to the PBGC, has expressed concern that UAL's marketing agreements and ticket guarantees do not outweigh the significantly lower cash amount offered by UAL compared to the cash potentially available from third parties. PBGC believes that, in these circumstances, the best interests of creditors are served by not approving assumption of the UAL Agreement at this time."

The foregoing facts and information were falsely stated to the DOT, and in some instances deliberately withheld. In its January 22, 1991 Answer to the DOT, United also makes false statements to the DOT regarding its adherence to labor commitments made in the Pacific route transfer case.

CONCLUSION

There have been bids by American Airlines, Delta and TWA for Pan Am's routes, and a bid by Tra-Cinda Corporation for all of Pan Am -- all at prices considerably higher than United's low bid. The more that is obtained for Pan Am's routes, the less will be the impact upon the hapless taxpayer for the $800 million pension fiasco that Pan Am will ultimately be tossing into their collective laps. Consequently, it could not possibly be in the public's interest to transfer Pan Am's London routes to United at United's considerably lower bid -- and could not be in keeping with the Section 401(h)(1) and Section 401(h)(2) requirements that a route can only be transferred if it is in the public interest.

I request that the Aviation Subcommittee see to it that this matter, and the myriad of false statements made by Pan Am and United, "do not blow by Secretary Skinner", regardless of how diligently he may try to wear horse blinders in the instant case.

Respectfully submitted,

Marion Kindig

Marion Kindig

Attachments

Exhibit 1

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D. C.

Joint Application of

UNITED AIRLINES, INC.
and
PAN AMERICAN WORLD AIRWAYS, INC.

for certificate transfer under
Section 401(h) of the Federal
Aviation Act of 1958, as amended

Docket 47237

MOTION TO FILE AN OTHERWISE UNAUTHORIZED DOCUMENT AND REPLY OF MARION KINDIG TO THE JOINT ANSWER OF PAN AMERICAN WORLD AIRWAYS, INC. AND UNITED AIR LINES, INC. TO OBJECTIONS TO ORDER 91-1-11

Communications with respect to this document should be sent to:

MARION KINDIG
President - R. O. B.
P. O. Box 15503
Washington, D. C. 20003
(202) 544-1400

Dated: January 24, 1991

STATEMENT

Since I was named in the Joint Answer of Pan American World Airways, Inc., and United Air Lines, Inc. to Objections to Order 91-1-11, filed on January 22, 1991, and since they distorted the situation therein involving me and the facts and circumstances involved in a case filed with the United States District Court of Northern California in Kindig v. Pan American World Airways, Inc., et al., Civ No. 86-0198 RHS, I hereby request leave to make the following statement to clear my reputation and to clarify the situation:

Under the Information Response to the Department of Transportation (attached as Exhibit "A") in connection with the purchase agreement, United Airlines represented to the DOT that United has

> "determined that seniority will be a major criterion for extending offers of employment to flight deck personnel and flight attendants currently employed by Pan Am after the Pacific Division transfer is approved. Also, to protect the expectations of those who most frequently fly the Pacific routes and to minimize disruption to both Pan Am and its employees, offers of employment will be made by base ('domicile' in United parlance) in proportion to the amount of Pacific flying done by employees located at that base."

United further represented to the DOT:

> "For flight attendants, offers will be extended first, proportionately by bases from which Pacific flying is done, to Pacific language-qualified flight attendants in seniority order; then to other Pacific language-qualified flight attendants in seniority order regardless of base; and finally to other flight attendants in seniority order, proportionately by bases from which Pacific flying is done until all positions are filled."

The figures used for calculating the percentage of Pacific flying from each base and Pacific language qualified flight attendants are attached as Exhibit "B".

In response to a letter from Richard Ferris (at the time Chairman of United Airlines, Inc.) dated September 25, 1985, (attached as Exhibit "C"), I sent my filled-out employment application (attached as Exhibit "D") by certified mail, return receipt requested (attached as Exhibit "E").

In reply I received an employment packet mailed by United on November 27, 1985, (attached as Exhibit "F").
This included a letter from Diane Sena, Vice President Inflight Services dated November 25, 1985, (attached as Exhibit "G"), which states:

> "Job offers will be made to Pan Am flight attendants who meet our medical and training requirements. The order of selection will be:
>
> 1. Pacific language qualified employees in LAX, HNL, JFK and MIA.
> 2. Other employees in LAX, SFO, HNL and JFK in seniority order by base.
> 3. If positions are still available, other employees in seniority order systemwide."

The packet also included an Employment Confirmation Statement which I filled out and sent by certified mail on December 3, 1985, and was received by United on December 5, 1985, (attached as Exhibit "H"); a medical examination form -- which medical examination I passed with flying colors in December, 1985; and a Training Information Letter (attached as Exhibit "I") -- which classes I attended and passed as per the schedule attached as Exhibit "J". In addition, I was a senior flight attendant at the San Francisco base, and I speak some Japanese -- as well as 2 other foreign languages, one of which is very fluent.

I sent in another United Airlines Employment Acceptance Statement on January 3, 1986,by Express Mail (attached as Exhibit "K"). I sent in another United Employment Acceptance by Express Mail dated January 21, 1986 (attached as Exhibit "L"). On January 22, 1986 an Order to Show Cause and Temporary Restraining Order was filed in the Northern District Court of California (attached as Exhibit "M"). It ordered that:

> "Pan Am shall advise immediately United Airlines of Marion Kindig's status as a former employee who may, pending the results of ongoing grievance proceedings, be restored to her status as a Pan Am employee. Consequently, she may be eligible for United Airlines' offer of employment to Pan Am flight attendants, which, according to plaintiffs, expires January 23, 1986."

On February 7, 1986, Judge Eugene Lynch ordered that

Pan Am

> "shall immediately change Pan Am's employment records to reflect the restoration of plaintiff Marion Kindig to active employment status in such a manner and for such period as is required for consideration by United Airlines for her hiring as a flight attendant in connection with the current change over of personnel from Pan Am to United pursuant to United's acquisition of Pan Am's Pacific routes and in accord with the intent of this Order". It was further ordered that, Pan Am "shall immediately advise United Airlines of Marion Kindig's active employment status in such a manner as to make possible consideration for her employment as a flight attendant by United Airlines".

This Order was telephoned to United's legal department the morning of February 10, 1986, and the Order was signed on February 11, 1986. (Order attached as Exhibit "N".)

Dozens of Pan Am flight attendants who had been accepted by United were rejected by United at the last moment for medical reasons. In addition, numerous Pan Am flight attendants decided to change their minds at the last moment, and offers of employment were made to Pan Am flight attendants at the San Francisco base until on or about February 26, 1986, in order to obtain the 1,202 quota. United hired the most junior flight attendants at the San Francisco base -- who were at a much lower salary level -- and simply ignored the Court's Order; the reaffirmation of that Order by a subsequent arbitrator's award; and the representations made to the DOT regarding the manner in which United would hire Pan Am flight attendants; and the sworn testimony before the DOT by United's Senior Vice President for Human Resources, Mr. David Pringle,as to how United would hire Pan Am flight attendants. (See Attached Exhibit "O".)

When this was brought up in the aforementioned federal court case, United informed the court that it was not bound by any commitments it had made to the Department of Transportation regarding the representations it had made to accept Pan Am employees. United argued that it was "implausible to suggest that United made a legally binding promise" based in its DOT filings. See Note 1. The statement contained in the Joint Answer of Pan Am and United dated January 22, 1991, that:

> "The Kindig litigation referred to by IUFA did not involve United's adherence to the labor commitments contained in its acquisition agreement with Pan Am"

is a total fabrication and falsehood, as one of the main issues of the case was that United totally disregarded the labor commitments contained in its acquisition agreement with Pan Am and the representations which it had made to the DOT. To this day, United

Note 1. Statements made by United in Kindig v. Pan American World Airways, Inc., et al. No C86-0198 United Memorandum of Points and Authorities in Support of Motion to Dismiss and/or for Summary Judgment, Jan. 9, 1987; Reply Memorandum of United in Support of Motion to Dismiss and/or Summary Judgment, Feb. 6, 1987; and United Memorandum of Points and Authorities in Support of Motion to Dismiss, Oct. 16, 1987.

blatantly continues,to ignore the aforementioned Court Order; and the representations made to the DOT; and Pan Am continues to ignore the arbitrator's award. Both Pan Am and United have engaged in conduct which would offend the nostrils of any decent human being. It should further be noted that in the instant case, United is again continuing its policy of hiring the most junior at the lowest salaries by offering to hire junior Pan Am flight attendants who are "excessed" by Pan Am during 1991 -- instead of conforming to the accepted industry-wide policy of hiring by seniority.

THE $800 MILLION FRAUD

On January 8, 1991, Pan Am filed for Chapter 11 and dumped its $800 million pension liability (according to PBGC figures) into the lap of the Pension Benefit Guaranty Corporation. A major problem is that the PBGC is itself woefully underfunded, and at the moment faces a total pension plan underfunding of $40 billion. In a report by the former Inspector General of the DOL, Mr. Raymond Maria, he warned that the nation's pension funds, worth some $1.6 trillion in the aggregate, have been "looted by fraud and abuse that will dwarf the savings-and-loan scandal when it comes to light".

Since 1980, Pan Am has engaged in a continuous plundering of its pension plans in what appears to violate numerous sections of the ERISA laws and the applicable IRS Code. A special prosecutor needs to be assigned to determine whether criminal sanctions are in order.

In the PBGC's Response dated January 10, 1991, in the Pan Am Chapter 11 Bankruptcy, the PBGC listed numerous objections to the sale of Pan Am's London routes to United, namely:

> "The Debtors contend that assumption of the UAL Agreement and the transfer to UAL of Airways' route authorities between the United States and London Heathrow Airport pursuant to the UAL Agreement is "essential to Debtors' ability to continue their current operations and reorganize in these cases." However, the PBGC objects to the Debtors' linking of DIP financing with the UAL Agreement to create an artificial emergency. Further, there is no showing before this Court that such a linkage is in the best interest of Debtors, their estates and their creditors."
>
> "Debtors make no demonstration whatsoever in their Motion that the extraordinary authorization to sell the London Routes to UAL, without offering that opportunity to others in an open bidding procedure, is appropriate."
>
> "As reported in a Wall Street Journal article on October 29, 1990, page B1, American Airlines proposed to offer Pan Am $200 million more for the London Routes than the cash price in the UAL Agreement, but was precluded from pursuing that transaction by the existence of the "lock up" provisions of the UAL Agreement."
>
> "Recent events point to a conclusion that the purchase price in the UAL Agreement is too low."
>
> "The PBGC believes that a sale of the London Routes on the terms of the UAL Agreement may jeopardize the ultimate goal of successful reorganization of Debtors' business. By Debtors' own calculations the London Routes comprise over 20% of Pan Am's revenues and are routes into an important restricted access airport, unlike many of Pan Am's remaining European routes. With the loss of these routes at the commencement of its Chapter 11 case, Airways will substantially reduce its attractiveness to prospective business partners."
>
> "The PBGC contacted three major financing institutions, each of which is recognized as a leader in providing DIP financing. These institutions expressed interest to the PBGC in providing DIP financing to Debtors; however, they were never contacted by the Debtors. In fact, Debtors have not indicated to the Court that they contacted anyone about DIP financing other than Bankers Trust. The institutions contacted by the PBGC further indicated that such financing might not be contingent on approval of the sale of the London routes to UAL."
>
> "This Court has seen no evidence that the value to Debtors of a complex joint marketing arrangement outweighs the value of additional cash for the London Routes. Debtors argue that immediate approval of the joint Comprehensive Marketing

> Agreement and reciprocal Frequent Flyer Agreements (the "Related Agreements") is essential to avoid irreparable harm. The PBGC submits that such approval is not urgently required since the benefits to the Debtors contemplated under the Related Agreements will not become available until after consummation of Phase II of the UAL Agreement, an event which cannot possibly occur before final approval of the transfer is granted by the governments of both the United States and the United Kingdom."
>
> "Smith Barney, the financial advisor to the PBGC, has expressed concern that UAL's marketing agreements and ticket guarantees do not outweigh the significantly lower cash amount offered by UAL compared to the cash potentially available from third parties."
>
> "PBGC believes that, in these circumstances, the best interests of creditors are served by not approving assumption of the UAL Agreement at this time. Rather, this Court should delay any action on assumption of the UAL Agreement in order to open the sale of the London Routes for competitive bidding that will maximize the benefits to the estate. The Court should not allow the Debtors to sell one of their most substantial assets two days into a Chapter 11 case at a price that that has been seriously questioned in the courts, in the marketplace, and by the Debtors' largest creditor."
>
> "In light of the foregoing, the PBGC respectfully requests that the Court order the Debtors to seek alternative DIP financing, not linked to the UAL Agreement, in order to provide all interested parties the opportunity to bid for the London routes."

Although the Court is not bound to act in the public interest, the Secretary of the Department of Transportation is.

> "Section 401(h)(1) provides that a certificate may only be transferred it it is determined to be in the public interest."
>
> "Section 401(h)(2) provides that the Secretary of Transportation is required, upon any transfer of a certificate, to certify to the Committee on Commerce, Science and Transportation of the Senate and the Committee on Public Works and Transportation of the House of Representatives that the transfer is consistent with the public interest."

CONCLUSION

Since the Pan Am-United London route transfer, as presently structured and at the current fire sale price, could not possibly be in the public interest,the Secretary could not, in good faith certify to the Senate and to the House of Representatives that a route transfer so totally disasterous to the public at large, could, in fact, be in the public interest.

1. It would be unconscionable and unscrupulous to foist Pan Am's $800 million fraud upon the public.
2. It would clearly be detrimental to the public interest not to obtain the maximum from Pan Am's assets so as to minimize and defray as best as possible the cost to the hapless taxpayer.
3. As a result of the UAL "lock up" agreement the maximum is not being obtained from Pan Am's assets, and is clearly contrary to the best interest of the public.
4. On today's radio program there was an announcement that there will be large fare increases by United Airlines on the routes which Eastern had flown -- because of no competition, a portend of things to come.
5. The UAL "lock up" agreement is preventing the competition which the Department has consistently sought to achieve.
6. If this transaction is granted, it will tend to create 2 super carriers.

The only lame argument that Pan Am and United can muster in their January 22, 1991, Answer to Objections to Order 91-1-11, is that granting final approval of the route transfer is in Pan Am's best interest. However, nowhere in Sections 401(h)(1) and 401(h)(2) is there a provision for Pan Am's best interest. Those sections very clearly state that the route transfer must be in the public interest. Clearly the present transaction is not.

Pan Am and United's case is so devoid of any substance, that they find it necessary not only to make repeated false statements, but to claim that they have addressed all issues. They have studiously avoided addressing the $800 million fraud being foisted upon the public, which was brought to light in DOT filings on January 2, 1991, and January 18, 1991.

WHEREFORE, it is prayed that:

a. Pan Am and United be ordered to submit a Supplemental Joint Answer to Objections to Order 91-1-11, which addresses the $800 million pension fraud which is being perpetrated upon the public.

b. That an oral evidentiary hearing be held to determine what is actually in the public interest and to explore such issues as the pension problem; the lack of competi- this transaction will foster; the fire sale price at which United is attempting to obtain these assets for; the effects that this fire sale price and United's "lock up" agreement will have on what the public will ultimately have to pay for Pan Am's $800 million pension fraud; and what terms the United Kingdom will propose in order to consummate this route transfer. It would be preposterous to come to the conclusion that any agreement with the United Kingdom would be consistent with the public interest when the terms and conditions of said agreement are an unknown factor.

c. That the route transfer in its present form be denied.

d. Pan Am and United be ordered to explain in its Supplemental Joint Answer to Objections to Order 91-1-11, the reasons for their deliberate false statements in their Answer filed on January 22, 1991, as to the representations United had made to the DOT in order to gain approval of the Pacific Route Transfer, and how United later blatantly breached and violated those representations -- in fact baldly stating to the Court in Case No. C86-1098 that it was not bound by any commitments it had made to the Department of Transportation regarding the manner in which it would hire Pan Am employees and arguing that it was "implausible to suggest that United made a legally binding promise" based on its DOT filings.

United is attempting to create a false sense of urgency in order to quickly push through a route transfer which it would be obtaining at bargain basement prices -- and well below the going market rate -- and before the issues can thoroughly be explored to determine how totally disasterous the proposed London route sale would be to the public interest.

Respectfully submitted,

Marion Kindig

MARION KINDIG
President - R. O. B.
P. O. Box 15503
Washington, D. C. 20003
(202) 544-1400

Dated: January 24, 1991

Exhibit "A"

UA-IR-610

Supplement to Information Response III.A.4.j.[*]

In an effort to hire the most experienced and qualified personnel, and to accommodate the concerns raised in the filings of the labor parties in this case, United has determined that seniority will be a major criterion for extending offers of employment to flight deck personnel and flight attendants currently employed by Pan Am after the Pacific Division transfer is approved. Also, to protect the expectations of those who most frequently fly the Pacific routes and to minimize disruption to both Pan Am and its employees, offers of employment will be made by base ("domicile" in United parlance) in proportion to the amount of Pacific flying done by employees located at that base. There will be two exceptions to the plan to hire proportionally by base to accommodate the need for L-1011-qualified flight deck personnel and Pacific language-qualified flight attendants.

For non-L-1011 flight deck personnel, offers of employment will be extended proportionally by bases from which Pacific flying is done to all pilot-qualified personnel qualified to fly 747 equipment, by seat and in seniority order until the appropriate number for that base have been hired. For L-1011 flight deck personnel, offers will be made regardless of base to pilot-qualified personnel by seat and in seniority order.

---

[*] Although the information request specifically asked only about flight attendants, United's supplemental response is also directed to the method of selection of flight deck personnel, in the interest of completeness and because of the interest of Pan Am flight deck employees in the subject.

For flight attendants, offers will be extended first, proportionally by bases from which Pacific flying is done, to Pacific language-qualified flight attendants in seniority order; then to other Pacific language-qualified flight attendants in seniority order regardless of base; and finally to other flight attendants, in seniority order, proportionally by bases from which Pacific flying is done until all positions are filled.

The figures necessary for calculating the percentage of Pacific flying from each base will be obtained from Pan Am, as will information regarding Pacific language-qualified flight attendants.

Exhibit "B"

Docket 43065
PA-IR-616
Page 1 of 1

PACIFIC LANGUAGE SKILLS -- PAN AM FLIGHT ATTENDANTS

In response to the request for information by the Association of Flight Attendants presented at the hearing on August 6, 1985, Pan Am submits the following estimate[1] of the number of current Pan Am flight attendants with Pacific language skills:[2]

BASE	NUMBER OF FLIGHT ATTENDANTS WITH PACIFIC LANGUAGE SKILLS
Honolulu	180
New York	74
San Francisco	66
Los Angeles	41
London	10
Miami	4
TOTAL	375
TOTAL FLIGHT ATTENDANT WORK FORCE	5662

---

[1] Estimate based upon central personnel data bank of language skills. Does not include data from any language information lists which may be maintained at the bases, or language skills which have not been reported to Pan Am.

[2] Includes only Japanese, Chinese (Mandarin, Cantonese, and Shanghai), and Korean.

Docket 43065
Exhibit JA-R-600
Page 3 of 4

II. REBUTTAL TO DIRECT EXHIBITS AND TESTIMONY OF THE INDEPENDENT UNION OF FLIGHT ATTENDANTS

(Exhibit IUFA-T-1)

IUFA has represented that flight attendants at all Pan Am bases, excluding London, are engaged in Pacific flying. The following table indicates the number of pattern pay credited hours flown by flight attendants at each base which are attributable to Pacific route flying for the June 1985 schedule.

Base	Total Pattern Pay Credited Hours	Pacific Pattern Pay Credited Hours	Percentage of Base Pattern Pay Credited Hours Flown on Pacific Routes	Percentage of Pacific Pattern Pay Credited Hours Flown From Base
Honolulu	28,203	21,755.7	77.1%	33.9%
San Francisco	46,898	14,998	32.0	23.4
Los Angeles	31,886	8,517.5	26.7	13.3
New York	107,743	11,928.1	11.1	18.6
Miami	73,208	6,883.6	9.4	10.7
London	-	-	0	0

Exhibit "C"

UNITED AIRLINES

Office of the Chairman

September 25, 1985

Dear Pan American Flight Attendant:

Government review of United's purchase of Pan Am's Pacific operation is underway and approval should be obtained in the near future. Part of the purchase agreement calls for United to employ 1202 Pan Am flight attendants. The 1202 individuals will be selected from those who apply with consideration being given to Pacific-language qualifications, current base assignment and seniority.

The purpose of the enclosed packet is to provide you information about United and to determine your interest in being considered for one of the 1202 positions. Our wages, benefits and working conditions are among the best in the industry. And, we have aggressive growth plans for the future. I would like to be able to provide you with details of work rules and seniority integration but these issues have not been finalized with the union, the Association of Flight Attendants. We plan that former Pan Am flight attendants will be assimilated in a fair and equitable manner into the existing United flight attendant group. We will, of course, provide additional information as soon as it becomes available.

We know you will have many questions as you evaluate this opportunity. To assist you in making an informed decision, we will set up a hotline you can contact between 7:00 a.m. and 7:00 p.m. (CST) to get prompt answers to questions about United. The number is 1-800-722-8251, and will be in service starting October 7.

If you decide you want to be considered for one of the 1202 positions here at United, please fill out the enclosed response form and return it by October 22. We look forward to welcoming you to the United team.

Sincerely,

Dick Ferris

Richard J. Ferris
Chairman

RJF:lms

P.O. Box 66100, Chicago, Illinois 60666 • Location: Elk Grove Township, Illinois, on Route 62, one-half mile west of Route 83

Exhibit "D"

201 Wilcrest Drive, #738
Houston, Texas 77042
(713) 785-1767

October 16, 1985

Mr. Richard J. Ferris, Chairman
United Airlines
P. O. Box 66100
Chicago, Illinois 60666

Dear Mr. Ferris:

In response to your letter of September 25, 1985, enclosed is my filled-out application for consideration of being selected among the 1202 Pan Am flight attendants to go with United Airlines.

I am in excellent health, and am sure that I will have no difficulty in passing United Airlines' physical examination.

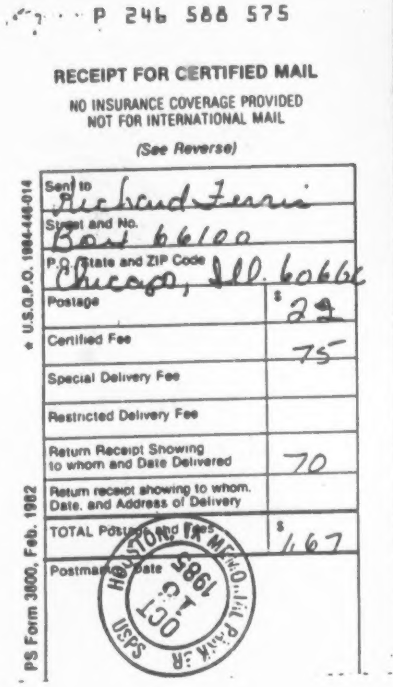
I look forward to hearing from you in the near future.

Sincerely yours,

Marion Kindig

Enclosure 1

Exhibit "E"



P 246 588 575

RECEIPT FOR CERTIFIED MAIL

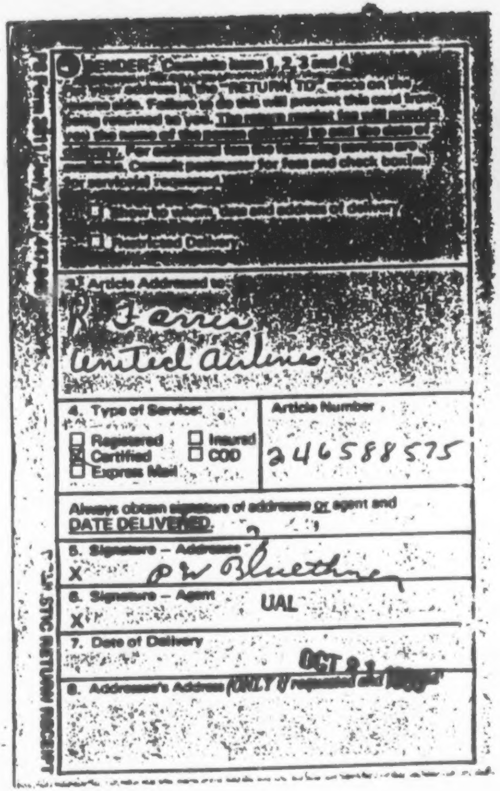
NO INSURANCE COVERAGE PROVIDED
NOT FOR INTERNATIONAL MAIL

(See Reverse)

Sent to Richard Ferris	
Street and No. Box 66100	
P.O., State and ZIP Code Chicago, Ill. 60666	
Postage	$ .22
Certified Fee	75
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	70
Return receipt showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	$ 1.67
Postmark or Date	HOUSTON TX MEMORIAL PARK OCT 13 1985 USPS

★ U.S.G.P.O. 1984-446-014

PS Form 3800, Feb. 1982



PS Form 3811, July 1983 447-845

DOMESTIC RETURN RECEIPT

SENDER: Complete items 1, 2, 3 and 4. Put your address in the "RETURN TO" space on the reverse side. Failure to do this will prevent this card from being returned to you. The return receipt fee will provide you the name of the person delivered to and the date of delivery. For additional fees the following services are available. Consult postmaster for fees and check box(es) for service(s) requested.

1. ☐ Show to whom, date and address of delivery.
2. ☐ Restricted Delivery.

3. Article Addressed to:
R. Ferris
United Airlines

4. Type of Service: ☐ Registered ☐ Insured ☒ Certified ☐ COD ☐ Express Mail	Article Number 246588575

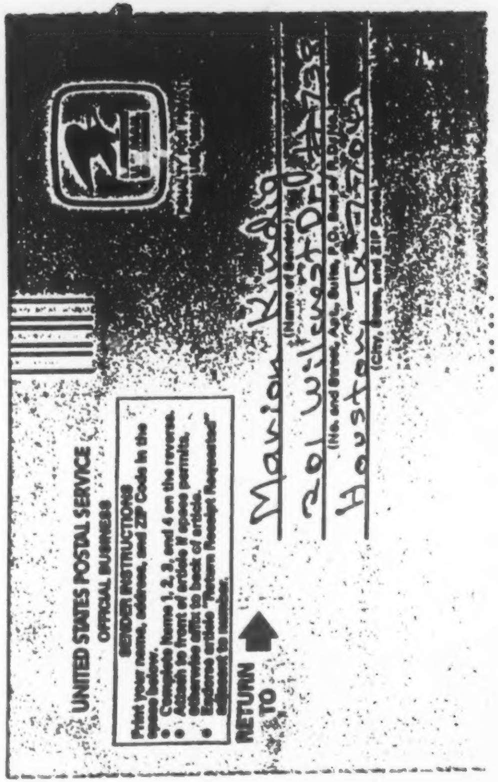
Always obtain signature of addressee or agent and DATE DELIVERED.

5. Signature – Addressee
X P W Bluethin

6. Signature – Agent
X UAL

7. Date of Delivery
OCT 21

8. Addressee's Address (ONLY if requested and fee paid)



UNITED STATES POSTAL SERVICE
OFFICIAL BUSINESS

SENDER INSTRUCTIONS
Print your name, address, and ZIP Code in the space below.
- Complete items 1, 2, 3, and 4 on the reverse.
- Attach to front of article if space permits, otherwise affix to back of article.
- Endorse article "Return Receipt Requested" adjacent to number.

PENALTY FOR PRIVATE USE

RETURN TO

Marion Kindig
(Name of Sender)
201 Wilcrest Dr #738
(No. and Street, Apt., Suite, P.O. Box or R.D. No.)
Houston, Tx 770[illegible]
(City, State, and ZIP Code)

Exhibit "F"

AMF O'HARE
NOV 27 '85
IL

U.S. POSTAGE
00.56
METER 2504220

FIRST CLASS MAIL

UNITED AIRLINES

KINDIG, MARION
201 WILCREST DRIVE #738
HOUSTON TX
77042

Exhibit "g"

UNITED AIRLINES

November 25, 1985

Dear Pan Am Flight Attendant:

The response to our request for an expression of interest in joining United Airlines upon acquisition of the Pan American Pacific Division was excellent. Almost 2700 of you responded and we are delighted with your interest. We plan to cover the Pacific flight schedules from our San Francisco, Honolulu and Los Angeles domiciles. Therefore, this letter is being sent to flight attendants in these locations and JFK and to all Pacific language qualified flight attendants in those domiciles and Miami. Those of you who join us will be placed as follows:

Los Angeles	302
San Francisco	500
Honolulu	400
	1202

In Dick Ferris' September 25, 1985 letter to you, he advised that the issues of work rules and seniority integration had not been resolved with the Association of Flight Attendants. We still do not have an agreement with them, but most terms and conditions of employment have been tentatively resolved with the AFA. These issues are still subject to final agreement but we do not expect them to be changed. We want you to be aware of them so you can make an employment decision based upon the facts as we know them today. These terms and conditions are:

- Pay will be based on flight attendant seniority at Pan Am, adjusted on the same basis as United flight attendants (e.g. for furlough, leave of absence, etc.). See Attachment F.
- The normal probationary period will be waived.
- Disciplinary actions will be considered removed from the records.
- United's height requirements will be waived for the Pacific Division purchase only and current Pan American Flight Attendants will be considered for employment regardless of height.
- Normal eligibility waiting periods for LTD insurance and high-limit life insurance will be waived, and you will be eligible immediately.
- Sick leave banks will be credited with an amount equal to the employee's Pan Am sick leave bank.

P.O Box 66100 Chicago, Illinois 60666 • Location Elk Grove Township, Illinois, on Route 62, one-half mile west of Route 83

We expect to be in a position to make final job offers soon. Job offers will be made to Pan Am flight attendants who meet our medical and training requirements.

The order of selection will be:

1. Pacific language qualified employees in LAX, SFO, HNL, JFK and MIA.
2. Other employees in LAX, SFO, HNL and JFK in seniority order by base.
3. If positions are still available, other employees in seniority order systemwide.

United is a great company with tremendous growth potential and we appreciate your interest and cooperation as we move toward the Pacific Division acquisition. We look forward to your joining us and to the exciting times ahead as United expands into the Pacific.

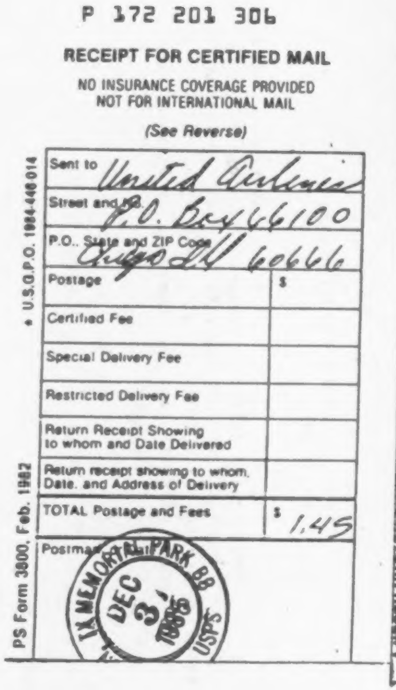
Sincerely,

Diane

Diane Sena
Vice President
Inflight Services

Attachments

Exhibit "H"



P 172 201 306

RECEIPT FOR CERTIFIED MAIL

NO INSURANCE COVERAGE PROVIDED
NOT FOR INTERNATIONAL MAIL

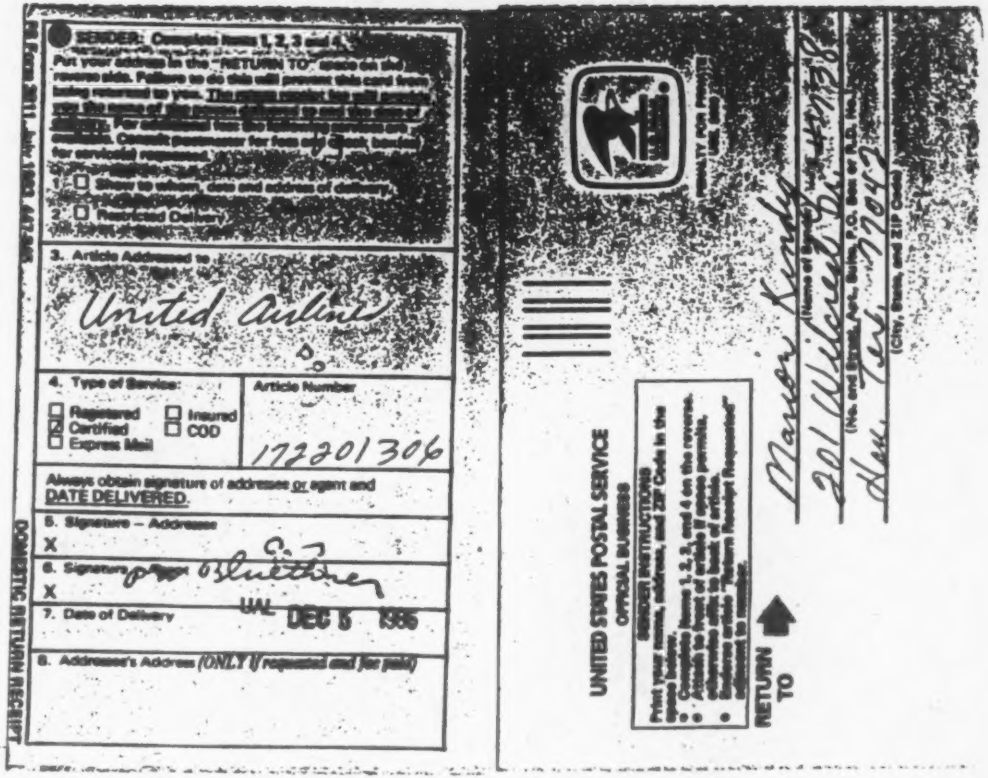
(See Reverse)

Sent to United Airlines	
Street and No. P.O. Box 66100	
P.O., State and ZIP Code Chicago Ill 60666	
Postage	$
Certified Fee	
Special Delivery Fee	
Restricted Delivery Fee	
Return Receipt Showing to whom and Date Delivered	
Return receipt showing to whom, Date, and Address of Delivery	
TOTAL Postage and Fees	$ 1.45
Postmark or Date	

IX MEMORIAL PARK BB
DEC 3 1985
USPS

PS Form 3800, Feb. 1982

* U.S.G.P.O. 1984-446-014



PS Form 3811, July 1983 447-845

DOMESTIC RETURN RECEIPT

SENDER: Complete items 1, 2, 3 and 4.
Put your address in the "RETURN TO" space on the reverse side. Failure to do this will prevent this card from being returned to you. The return receipt fee will provide you the name of the person delivered to and the date of delivery. For additional fees the following services are available. Consult postmaster for fees and check box(es) for service(s) requested.

1. ☐ Show to whom, date and address of delivery.
2. ☐ Restricted Delivery.

3. Article Addressed to:
United Airline

4. Type of Service:
☐ Registered ☐ Insured
☑ Certified ☐ COD
☐ Express Mail

Article Number
172201306

Always obtain signature of addressee or agent and DATE DELIVERED.

5. Signature – Addressee
X

6. Signature – Agent
X

7. Date of Delivery
UAL DEC 5 1985

8. Addressee's Address (ONLY if requested and fee paid)

UNITED STATES POSTAL SERVICE
OFFICIAL BUSINESS

SENDER INSTRUCTIONS
Print your name, address, and ZIP Code in the space below.
- Complete items 1, 2, 3, and 4 on the reverse.
- Attach to front of article if space permits, otherwise affix to back of article.
- Endorse article "Return Receipt Requested" adjacent to number.

RETURN TO

PENALTY FOR PRIVATE USE, $300

Marion Kundy
(Name of Sender)

201 Wilcrest Dr. #43938
(No. and Street, Apt., Suite, P.O. Box or R.D. No.)

Hou, Tex. 77042
(City, State, and ZIP Code)

Exhibit "I"

PAN AMERICAN
FLIGHT ATTENDANT TRAINING

We appreciate your interest in being employed by United Airlines upon the acquisition of Pan American's Pacific Division. There are certain training obligations that must be met in order for you to qualify to fly for us. Those of you who have not already completed all or a portion of the Phase I training must complete this phase. There will be two phases of training that will occur over a six-month period.

The first phase of training must be accomplished prior to employment and will include two days of emergency training and two days of services training.

The two days of emergency training will be held in HNL and SFO where aircraft mock-ups are available. For those of you who may not be based in either HNL or SFO and will need to travel to attend emergency training, transportation and hotel rooms will be provided. Arrangements for ticket pickup will be made by United personnel through Pan Am's Inflight Offices and notification of departure times, hotel information and class start times will be given to you.

The two days of services training will be held in HNL, LAX and SFO. These two days must be taken consecutively but may be taken separate from the two days of emergency training. The first day consists of Royal Pacific services, liquor and headset accounting procedures, and galley and equipment familiarization. (United Flight Attendants must also attend this day of training). The second day of training consists of some narrow body services (DC-8-71) and key position training. Key positions are the First Flight Attendant and wide body galley positions.

Prior to attending either the emergency training or the services training, you must pick up a copy of "You and United" which addresses the company code of conduct which you will be held responsible for; your United Airlines Inflight Handbook; and a self study packet that must be completed prior to attending services training. The Inflight Handbook must be taken to emergency training and will be needed for completion of the self study packet. All of these documents may be picked up from Pan Am Inflight offices in HNL, LAX and SFO.

Phase II of training will consist of a more extensive introduction to United Airlines with additional services training, emergency training on narrow-body aircraft flown in the international operation, duty free markets and procedures. Phase II will take place after the acquisition and you will receive more information regarding it at that time.

Attachment B

Exhibit "J"

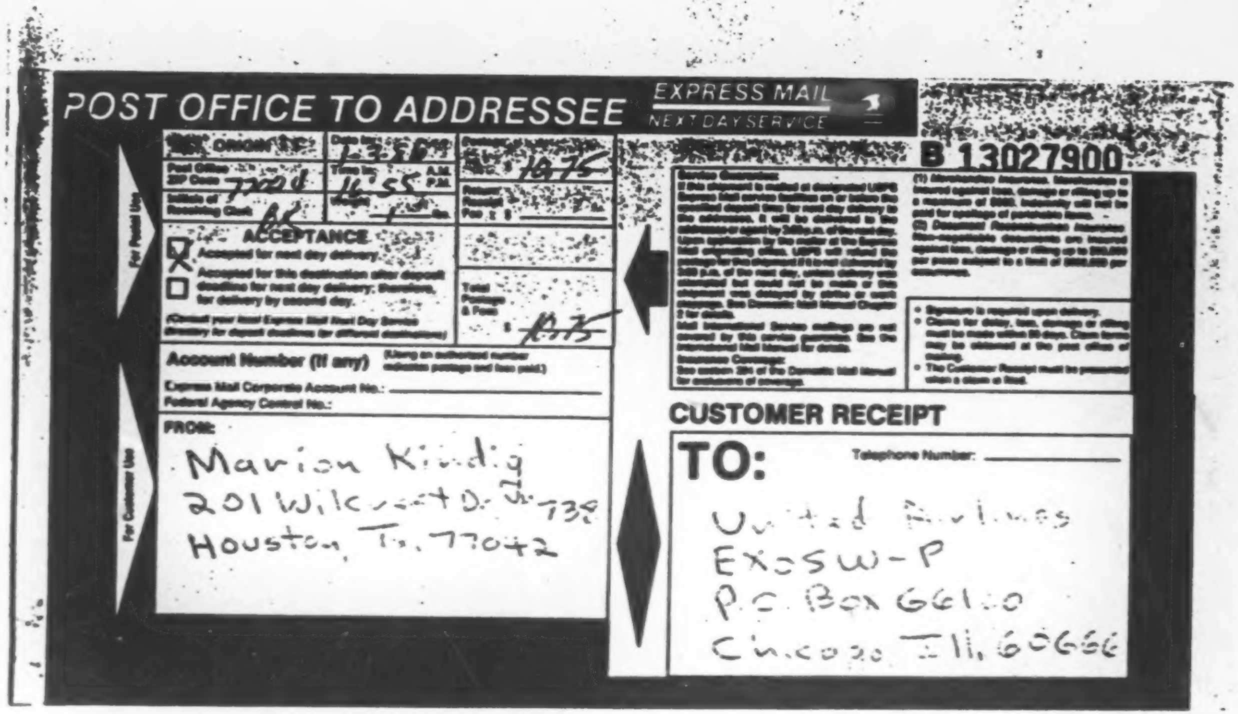
UAL

Training Dates

Emergency

Pan Am Rm 218	1-19-86	George Stanton - United
United Hangar	1-20-86	Hank Dinkmeat - United
Villa	1-22-86	PAA Instruct
Hotel	1-23-86	Joan Moynihan - Positio Training

Exhibit K



POST OFFICE TO ADDRESSEE

EXPRESS MAIL
NEXT DAY SERVICE

B 13027900

For Postal Use

ORIGIN

Post Office ZIP Code 77001

Initials of Receiving Clerk AK

Date In 1-3-86

Time In 16 55 A.M. P.M.

Weight 1 lbs.

Postage $ 16.75

Return Receipt Fee $

Total Postage & Fees $ 16.75

ACCEPTANCE

☒ Accepted for next day delivery.

☐ Accepted for this destination after deposit deadline for next day delivery; therefore, for delivery by second day.

(Consult your local Express Mail Next Day Service directory for deposit deadlines for different destinations.)

For Customer Use

Account Number (If any) (Using an authorized number indicates postage and fees paid.)

Express Mail Corporate Account No.:

Federal Agency Control No.:

FROM:

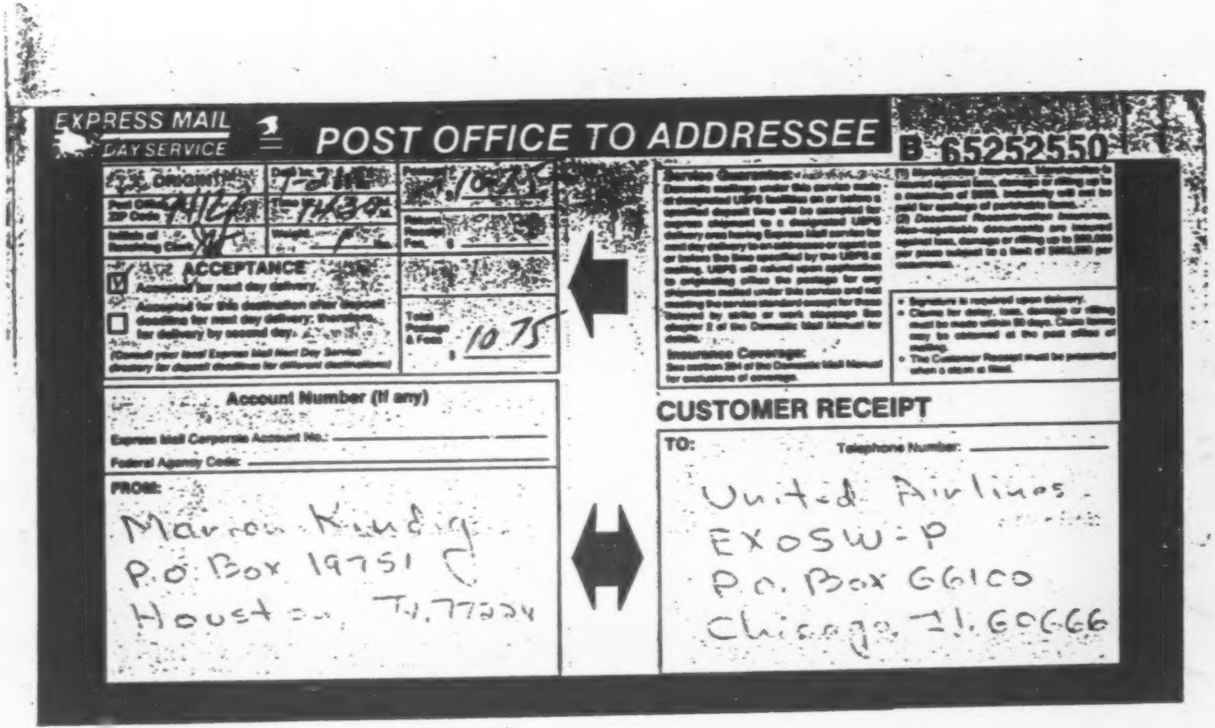
Marion Kindig
201 Wilcrest Dr. 739
Houston, Tx. 77042

- Signature is required upon delivery.
- Claims for delay, loss, damage or rifling must be made within 90 days. Claim forms may be obtained at the post office of mailing.
- The Customer Receipt must be presented when a claim is filed.

CUSTOMER RECEIPT

TO: Telephone Number:

United Airlines
EXOSW-P
P.O. Box 66100
Chicago Ill. 60666



EXPRESS MAIL
DAY SERVICE

POST OFFICE TO ADDRESSEE

B 65252550

ACCEPTANCE

☑

☐

Total Postage & Fees $ 10.75

Account Number (If any)

Express Mail Corporate Account No.:

Federal Agency Code:

FROM:

Marron Kunfig
P.O. Box 19751
Houston, Tx. 77224

CUSTOMER RECEIPT

TO:

Telephone Number:

United Airlines
EXOSW-P
P.O. Box 66100
Chicago, Il. 60666

Exhibit "M"

JAN [illegible]
[illegible]
U S DISTRICT COURT
NO DIST OF CA

IN THE UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

MARION KINDIG AND INDEPENDENT UNION OF FLIGHT ATTENDANTS, Plaintiffs, v. PAN AMERICAN WORLD AIRWAYS, INC., Defendants.	No. 86-0198 RES ORDER TO SHOW CAUSE AND TEMPORARY RESTRAINING ORDER

Plaintiffs' motion for a temporary restraining order was brought to preserve plaintiff Marion Kindig's future ability to gain employment with United Airlines in the event that her grievance with Pan American World Airways, Inc. ("Pa Am") results in her reinstatement as an employee. Kindig's underlying grievance concerns whether or not Pan Am should accept her recission of her resignation from the company as a flight attendant in March 1985.

Following (1) a review of plaintiffs' complaint, memorandum of points and authorities, and declarations and (2 a hearing on the motion at which plaintiffs and defendant wer represented, the court hereby grants a modified version of th emergency relief sought by plaintiffs.

It is hereby ORDERED, that defendant Pan Am shall advise immediately United Airlines of Marion Kindig's status as a former employee who may, pending the results of ongoing grievance proceedings, be restored to her status as a Pan Am employee. Consequently, she may be eligible for United Airlines' offer of employment to Pan Am flight attendants which, according to plaintiffs, expires January 23, 1986.

It is further ORDERED that defendant Pan American appear before this Court in Courtroom 6, 450 Golden Gate Avenue in San Francisco, California, at 10:00 a.m. on February 3, 1986, and show cause why this Court should not issue a preliminary injunction compelling Pan Am, its directors, officers, agents, servants, employees, and attorneys to change Pan Am's employment records to reflect the intent of this Court's order and to advise United Airlines of Marion Kindig's status as an employee eligible for employment.

The Court notes that this restraining order does not place a severe burden on defendant Pan Am nor does it adversely affect Pan Am's interests to any significant degree Rather, this order is designed to preserve one of Kindig's employment remedies should her grievance against Pan Am be resolved in her favor and she regains her job. See Brotherhood of Locomotive Engineers v. Missouri-Kansas-Texas R. Co., 363 U.S. 528, 534 (1960) (injunction may issue to promote interests of justice and preserve jurisdiction of National Railroad Adjustment Board action under Railway Labor Act).

Dated: January 22, 1986.

Chief United States District Judge

Exhibit "N"

ORIGINAL
FILED
FEB 11 1986

UNITED STATES DISTRICT COURT

NORTHERN DISTRICT OF CALIFORNIA

MARION KINDIG and INDEPENDENT UNION OF FLIGHT ATTENDANTS,
Plaintiffs,
v.
PAN AMERICAN WORLD AIRWAYS, INC.,
Defendant.

NO. C 86-0198 RHS

ORDER RE PRELIMINARY INJUNCTION

Upon a review of all pleadings on file in the herein matter and after hearing on Plaintiffs' Motion for Preliminary Injunction, this Court finds that it is possessed of subject matter jurisdiction to issue this Preliminary Injunction, and good cause appearing,

IT IS HEREBY ORDERED that defendant Pan American World Airways, its directors, officers, agents, servants, employees and attorneys shall immediately change Pan Am's employment records to reflect the restoration of plaintiff Marion Kindig to active employment status in such a manner and for such period as is required for consideration by United Airlines for her hiring as a flight attendant in connection with the current change over of personnel from Pan Am to United pursuant to United's acquisition of Pan Am's Pacific routes and in accord with the intent of this Order, and

IT IS FURTHER ORDERED that defendant Pan American World Airways, its directors, officers, agents, servants, employees and attorneys shall immediately advise United Airlines of Marion Kindig's active employment status in such a manner as to make possible consideration for her employment as a flight attendant by United Airlines, and

IT IS FURTHER ORDERED that the restoration of Marion Kindig is solely for the purpose of enabling United Airlines to fairly consider her for employment as a flight attendant and is without pay or benefit other than that described herein and without prejudice to the rights of either party in arbitration with respect to the underlying "minor" dispute in the action.

DATED: February 11, 1986

EUGENE F. LYNCH

Eugene F. Lynch, Judge
United States District Court

Exhibit "O"

201 Wilcrest Drive, #738
Houston, Texas 77042
(713) 785-1767

May 27, 1986

Mr. David Pringle
Senior Vice President for Human Resources
United Airlines
P. O. Box 66100
Chicago, Illinois 60666

Dear Mr. Pringle:

In your testimony before the Department of Transportion (in exhibit JA-T-3), you stated that you were personally familiar with United's plans to offer employment to Pan Am flight attendants, and you went on to describe United's objective in offering employment to former Pan Am flight attendants. You further testified that you participated in the decision regarding the plan with respect to offering employment opportunities with United, and that you are responsible for hiring and negotiating in accordance with joint considerations with the In-Flight Services and Marketing departments.

In subsequent testimony, you also expressed interest in hiring Pan Am flight attendants "who also had the Pacific language qualification that we were looking for". You further stated, "If they're all Pacific language qualified, for example, the most senior employee would come to work for United." "First by base and then on a systemwide seniority basis", "A judgement has been made from our Marketing department that if we're going to become an international carrier, that it would be a great benefit to have flight attendants onboard who spoke the languages to the countries that we are traveling".

After the Pacific language qualified flight attendants, (according to Exhibit JR-R-600) 23.4% were to be hired from San Francisco — "in seniority order" (according to JA-D-613). When asked under oath whether that would be "the seniority order as it appears in PAIR-604" (the Pan Am System Seniority List dated March 1, 1985) — you responded "Yes". As one other condition before an individual will be hired by United you stated, "They'll have to pass our physical examination".

You further stated under oath, "it's our intent, and we've made this representation on a good faith basis, that those are the criteria; pass the medical exam, we'll offer in seniority order in accordance with the three-pronged attack that we've done".

In UA-IR-610 it states, "For flight attendants, offers will be extended first, proportionally by bases from which Pacific flying is done, to Pacific language-qualified flight attendants in seniority order; then to other Pacific language-qualified flight attendants in seniority order regardless of base; and finally to other flight attendants, in seniority order, proportionally by bases from which Pacific flying is done until all positions are filled."

Undoubtedly, the Department of Transportation relied upon your representations (as well as the representations of other United Airlines employees) in making its final decision to approve the sale of Pan Am's Pacific Division to United Airlines. However, these representations have not been adhered to in my case. I meet all of the foregoing criteria.

1. I speak Japanese well enough so that I do not have to resort to English when I am in Japan. I never bothered to take the Pan Am Japanese qualification test, because there was no reason to do so. The language I am listed for is German (which I speak very fluently), and I also speak some French. I do not claim to speak Japanese fluently; however, I have a working knowledge of the language to the point where I am able to communicate with Japanese passengers. This was listed on my United Airlines employment application form.

2. I am listed in PAIR-604 as one of the more senior San Francisco flight attendants — the Pan Am System Seniority List dated March 1, 1985, which you testified you would hire from "in seniority order".

3. I have passed the United Airlines medical exam with flying colors.

On January 22, 1986, Judge Robert Peckham in the United States District Court for the Northern District of California issued a Temporary Restraining Order stating "It is hereby ORDERED, that defendant Pan Am shall advise immediately United Airlines of Marion Kindig's status as a former employee who may, pending the results of ongoing grievance proceedings, be restored to her status as a Pan Am employee. Consequently, she may be eligible for United Airlines' offer of employment to Pan Am flight attendants which, according to plaintiffs, expires January 23, 1986.

Since United Airlines did not fill its quota of 1,202 flight attendants from Pan Am with the offer which expired on January 23, 1986, an additional offer of employment was made by United Airlines to the San Francisco based flight attendants which expired on February 16, 1986.

On February 7, 1986, Judge Eugene F. Lynch of the United States District Court issued a Preliminary Injunction stating, "IT IS HEREBY ORDERED that defendant Pan American World Airways, its directors, officers, agents, servants, employees and attorneys shall immediately change Pan Am's employment records to reflect the restoration of plaintiff Marion Kindig to active employment status in such a manner and for such period as is required for consideration by United Airlines for her hiring as a flight attendant in connection with the current change over of personnel from Pan Am to United pursuant to United's acquisition of Pam Am's Pacific routes and in accord with the intent of this Order, and

"IT IS FURTHER ORDERED that defendant Pan American World Airways, its directors, officers, agents, servants employees and attorneys shall immediately advise United Airlines of Marion Kindig's active employment status in such a manner as to make possible consideration for her employment as a flight attendant by United Airlines".

Early on February 10, 1986, Judge Lunch's order was conveyed by telephone to both Mr. Glen Scoggins and also United's legal department. On February 11, 1986, this order was signed by Judge Eugene F. Lynch.

In total disregard of Judge Lynch's Order, junior flight attendants, (including the most junior flight attendant at the San Francisco base) were hired instead. This is in direct contempt of Judge Lynch's order. In the last paragraph of Judge Lynch's Order it states that the order was issued, "for the purpose of enabling United Airlines to fairly consider her for employment as a flight attendant". "Fairly" would presumably mean within the context of the criteria as set forth in your sworn tesitmony as to how the selection process would be handled.

Very truly yours,

Marion Kindig

Marion Kindig

PROOF OF SERVICE

I, Marion Kindig, declare as follows:

1. I reside in Washington, D. C.

2. I am over the age of 18 years. My mailing address is P. O. Box 15503, Washington, D. C. 20003.

3. I served the following on January 24, 1991:
MOTION TO FILE AN OTHERWISE UNAUTHORIZED DOCUMENT AND
REPLY OF MARION KINDIG TO THE JOINT ANSWER OF PAN AMERICAN WORLD AIRWAYS, INC., AND UNITED AIRLINES, INC. TO OBJECTIONS TO ORDER 91-1-11.

by causing one copy enclosed in a sealed envelope with postage thereon fully prepaid to be deposited in the United States Postal Depository in Washington, D. C., addressed to:

Mr. John E. Gillick
Winthrop, Stimson, Putnam & Roberts
1133 Connecticut Avenue, N. W., Suite 1200
Washington, D. C. 20036

Mr. Joel Stephen Burton
Ginsburg, Feldman and Bress, Chartered
1250 Connecticut Avenue, N. W., Suite 800
Washington, D. C. 20036

and an additional copy was served on each party listed on the "Service List" attached as Exhibit "A".

I declare under penalty of perjury that the foregoing is true and correct.

MARION KINDIG

Exhibit "A"

SERVICE LIST

Carl B. Nelson
American Airlines, Inc.
1101 17th Street, N.W.
Suite 600
Washington, D.C. 20036

Jonathan Blank
Preston, Gates, Ellis
& Rouvelas Meeds
1735 New York Ave., N.W.
Suite 500
Washington, D.C. 20590

Charles Angevine
Department of State
Office of Aviation
2201 C Street, N.W.
Washington, D.C. 20590

Michael Roberts
Verner, Liipfert, Bernhard,
McPherson & Hand
901 15th Street, N.W.
Suite 700
Washington, D.C. 20005

James Wilding
General Manager
Metropolitan Washington
Airports Authority
National Airport
Washington, D.C. 20001

Jerome A. Montgomery
Assistant City Attorney
City Attorney's Office
Department of Airports
1 World Way, Room 104
P. O. Box 92216
Los Angeles, CA 90009-2216

Ronald D. Eastman
Cadwalader, Wickersham
& Taft
Northwest Airlines, Inc.
1333 New Hampshire Ave., N.W.
Suite 700
Washington, D.C. 20036

Stephen L. Gelband
Hewes, Morella, Gelband
& Lamberton
1000 Potomac Street, N.W.
Washington, D.C. 20007

Robert Cohn
Shaw, Pittman, Potts
& Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037

William Alberger
Bishop, Cook, Purcell
& Reynolds
1400 L Street, N.W.
Washington, D.C. 20005

Jay Franke, Commissioner
Chicago Department of Aviation
20 N. Clark Street
Suite 300
Chicago, IL 60602

Frederick A. Elder
Peter Reaveley
Dade County Aviation Department
Miami Intl. Airport
P. O. Box 592075 AMF
Miami, FL 33159

Richard B. Jamison
Director of Airport
Detroit Metropolitan Wayne
County Airport
L.C. Smith Terminal
Detroit, MI 48242

Ambassador, British Embassy
3100 Massachusetts Ave., NW
Washington, D.C. 20008

Bruce Keiner
Crowell & Moring
1001 Pennsylvania Ave., NW
10th Floor
Washington, D.C. 20004

Paul M. Donovan
LaRoe, Winn, Moerman
& Donovan
1120 G Street, N. W.
Suite 800
Washington, D.C. 20005

Louis A. Turpen
Director - Airports
San Francisco Intl. Airports
P. O. Box 8097
San Francisco, CA 94128

Elliott M. Seiden
Vice President Law and
Government Affairs
Northwest Airlines, Inc.
901 15th Street, N.W.
Suite 300
Washington, D.C. 20005

Wesley Kennedy
Cotton, Watt, Jones & King
122 South Michigan Avenue
Suite 2050
Chicago, IL 60603

Michael F. Goldman
Steele, Goldman & Silcox
2020 K Street, N.W.
Suite 850
Washington, D.C. 20006-1806

David A. Borer, Director
Collective Barganing
Ben Elliott
Association of Flight
Attendants
1625 Massachusetts Ave. NW
Washington, D.C. 20036

Frank Cotter
Assistant General Counsel
Legal Department
USAir
Crystal Park Four
235 Crystal Drive, 8th Flr.
Arlington, VA 22227

Marshall S. Sinick
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
Suite 500
Washington, D.C. 20044

Joe Sims
Jones Day Reavis & Pogue
1450 G Street, N.W.
Suite 600
Washington, D.C. 20005

Kenneth A. Rowe
Virginia Department of
Aviation
4508 South Laburnum Ave.
Richmond, VA 23231

George N. Kenyon
Associate General Counsel
Trans World Airlines, Inc.
100 South Bedford Road
Mt. Kisco, NY 10549

Stephen B. Moldof
Cohen, Weiss and Simon
330 West 42nd Street
New York, NY 10036

Peter O. Shinevar
Bredhoff & Kaiser
1000 Connecticut Ave. NW
Suite 1300
Washington, D.C. 20036

Patrick J. Riley
International Brotherhood
of Teamsters
25 Louisiana Avenue, N.W.
Washington, D.C. 20001

Arthur M. Luby
O'Donnell, Schwartz
& Anderson
1300 L Street, N.W.
Suite 200
Washington, D.C. 20005

Vincent Tese
Commissioner, Department of
Economic Development
State of New York
1515 Broadway
New York, NY 10036

R. Daniel Devlin
Staff Vice President-
Legislative Affairs
Trans World Airlines, Inc.
808 17th St., NW, Suite 520
Washington, D.C. 20006

Denis F. Gordon
Gordon & Barnett
1133 21st Street, N.W.
Suite 450
Washington, D.C. 20036

R. Russell Bailey
Air Line Pilots Association
International
1625 Massachusetts Ave. N.W.
Washington, D.C. 20036

Charles Kurth
Kurth & Co., Inc.
4400 MacArthur Blvd., N.W.
Suite 303
Washington, D.C. 20007

Claire Shulman
President, Borough of Queens
120-55 Queens Boulevard
Kew Gardens, New York 11424

Exhibit "2"

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

In re PAN AM CORPORATION *et al.*, Debtors.	CHAPTER 11 CASE NOS. 91 B 10080 through 91 B 10087

RESPONSE OF PENSION BENEFIT GUARANTY CORPORATION TO MOTION FOR ORDER AUTHORIZING THE ASSUMPTION OF CERTAIN EXECUTORY CONTRACTS BETWEEN PAN AM CORPORATION, PAN AMERICAN WORLD AIRWAYS, INC. AND UNITED AIRLINES, INC.

TO THE HONORABLE CORNELIUS BLACKSHEAR,
UNITED STATES BANKRUPTCY JUDGE:

The Pension Benefit Guaranty Corporation, the Debtors' largest creditor, objects as follows to the Debtors' Motion for Order Authorizing the Assumption of Certain Executory Contracts (the "UAL Agreement") by and among Pan Am Corporation, Pan American World Airways, Inc., and United Airlines, Inc. ("UAL") and Approving the Assumption and Assignment of Executory Contracts and Unexpired Leases and the Sale of Assets Free and Clear of Liens, and respectfully represents:

BACKGROUND

1. The Pension Benefit Guaranty Corporation (the "PBGC") is a wholly-owned United States Government corporation created by section 4002 of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1301 *et seq*. (1988 ed.), to administer the mandatory pension plan termination insurance program established by Title IV of ERISA. The principal purpose of the PBGC is to insure the payment of certain pension benefits provided

by pension plans covered by Title IV of ERISA in the event such pension plans are terminated. 29 U.S.C. § 1302(a)(2).

2. Debtor, Pan American World Airways ("Airways"), maintains three underfunded pension plans covered under Title IV of ERISA. The estimated combined total underfunding for guaranteed benefits under these plans is approximately $600 million, with an additional underfunding for non-guaranteed benefits estimated to be approximately $200 million.

3. Pursuant to a Pledge Agreement dated September 17, 1990, between the PBGC and Pan Am Corporation, the PBGC holds a valid, perfected first priority security interest in 100% of the capital stock of Debtor, Pan Am Shuttle, Inc. to secure the payment of approximately $53 million in due and unpaid contributions owing to the plans. Pan Am Corporation has been in default of the Pledge Agreement continuously since October 26, 1990, for failure to make a contribution of $30 million to its pension plans required by the Internal Revenue Service and by the Pledge Agreement.

4. At present, Airways' pension plans have not been terminated. In the event the plans are terminated, Airways and any other trades or businesses under common control with the Airways (the "controlled group") will become jointly and severally liable to the PBGC under ERISA section 4062(b) for the amount by which the plans are insufficiently funded to pay benefit liabilities under the plans. Termination of the plans would also

give rise to separate joint and several claims by the PBGC on behalf of the plans for the unpaid contributions under ERISA section 4062(d). As a result the PBGC believes it is the single largest creditor of all the Debtors, with contingent termination liability claims of approximately $800 million, all or part of which may be entitled to priority under 11 U.S.C. § 507(a)(1) and/or (a)(7), and a secured unpaid contribution claim of approximately $53 million.

PBGC'S OBJECTIONS TO SALE OF LONDON ROUTES TO UNITED

5. The Debtors contend that assumption of the UAL Agreement and the transfer to UAL of Airways' route authorities between the United States and London Heathrow Airport pursuant to the UAL Agreement is "essential to Debtors' ability to continue their current operations and reorganize in these cases." Verified Motion at p. 12. The Debtors rely on the anticipated receipt of $290 million from UAL upon transfer of the London Routes as providing needed funds for continued operations. As support for their argument that the UAL Agreement is "essential", the Debtors point out that assumption of the UAL Agreement is a condition precedent to Debtors' receiving $150 million in secured post-petition financing "urgently needed" to maintain current operations until the UAL Agreement can be consummated.

6. The PBGC does not doubt that the Debtors are in a critical cash position, and that they have a need for debtor-in-possession financing ("DIP financing"). However, the PBGC objects to the Debtors' linking of DIP financing with the UAL

Agreement to create an artificial emergency. Further, there is no showing before this Court that such a linkage is in the best interest of Debtors, their estates and their creditors.

7. Debtors make no demonstration whatsoever in their Motion that the extraordinary authorization to sell the London Routes to UAL, without offering that opportunity to others in an open bidding procedure, is appropriate. To justify Debtors' entitlement to such an unusual request the Debtors are obligated to provide this Court and their creditors with clear and detailed evidence:

(A) That other alternatives to the sale of the London Routes to UAL do not exist -- The PBGC believes that such alternatives may in fact exist. As reported in a Wall Street Journal article on October 29, 1990, page B1, American Airlines proposed to offer Pan Am $200 million more for the London Routes than the cash price in the UAL Agreement, but was precluded from pursuing that transaction by the existence of the "lock up" provisions of the UAL Agreement;

(B) Whether the purchase price for the London Routes is adequate to compensate Debtors for the loss of their core assets and consistent with the market price for similar assets -- Recent events point to a conclusion that the purchase price in the UAL Agreement is too low. After being precluded from bidding for Pan Am's London Routes, American Airlines has agreed to pay TWA $445 million for a package of comparable London routes. Clearly, the "lock up" provisions of the UAL Agreement should have no effect in this bankruptcy case. However, if the Court grants Debtors' extraordinary motion no other potential purchaser will have the opportunity to take advantage of this newly-levelled playing field.

(C) That the sale of the London Routes will not block Debtors' ability to seek a business combination or capital infusion to successfully reorganize its affairs by disposing of one of the most attractive assets of Pan Am's business -- The PBGC believes that a sale of the London Routes on the terms of the UAL Agreement may jeopardize the ultimate goal of successful reorganization of Debtors' business. By Debtors' own calculations the London Routes comprise over 20% of Pan Am's revenues and are routes into an important restricted access airport, unlike many of Pan Am's remaining European routes. With the loss of these routes at the commencement of its Chapter 11 case, Airways will substantially reduce its attractiveness to prospective business partners.

(D) That DIP financing is only available to Debtors if the UAL Agreement is authorized today -- The PBGC contacted three major financial institutions, each of which is recognized as a leader in providing DIP financing. These institutions expressed interest to the PBGC in providing DIP financing to Debtors; however, they were never contacted by the Debtors. In fact, Debtors have not indicated to the Court that they contacted anyone about DIP financing other than Bankers Trust. The institutions contacted by the PBGC further indicated that such financing might not be contingent on approval of the sale of the London routes to UAL; and

(E) That the marketing arrangements in the UAL Agreement are so unique that no alternatives exist -- This Court has seen no evidence that the value to Debtors of a complex joint marketing arrangement outweighs the value of additional cash for the London Routes. Debtors argue that immediate approval of the joint Comprehensive Marketing Agreement and reciprocal Frequent Flyer Agreements (the "Related Agreements") is essential to avoid irreparable harm. The PBGC submits that such approval is not urgently required since the benefits to the Debtors contemplated under the Related Agreements will not become available until after consummation of Phase II of the UAL Agreement, an event which cannot possibly occur before final approval of the transfer is granted by the governments of both the United States and the United Kingdom.

8. The Debtors' argument that "the business justification for the United Agreement has already been tested in the courts and

in the market place," Verified Motion at p. 14, could not be further from the truth. No court has made a finding that the UAL Agreement is in the Debtors' best interest; nor does the withdrawal of one shareholder derivative suit, without knowing the reasons therefor, support such business justification. In addition, Smith Barney, the financial advisor to the PBGC, has expressed concern that UAL's marketing agreements and ticket guarantees do not outweigh the significantly lower cash amount offered by UAL compared to the cash potentially available from third parties.

9. PBGC believes that, in these circumstances, the best interests of creditors are served by not approving assumption of the UAL Agreement at this time. Rather, this Court should delay any action on assumption of the UAL Agreement in order to open the sale of the London Routes for competitive bidding that will maximize the benefits to the estate. The Court should not allow the Debtors to sell one of their most substantial assets two days into a Chapter 11 case at a price that has been seriously questioned in the courts, in the marketplace, and by the Debtors' largest creditor.

10. In light of the foregoing, the PBGC respectfully requests that the Court order the Debtors to seek alternative DIP

financing, not linked to the UAL Agreement, in order to provide all interested parties the opportunity to bid for the London Routes.

Respectfully submitted,

Dated: January 10, 1991

Kenton Hambrick

JOHN H. FALSEY
Deputy General Counsel
KENTON HAMBRICK
Attorney

PENSION BENEFIT GUARANTY
CORPORATION
Office of the General Counsel
2020 K Street, N.W., Suite 7200
Washington, D.C. 20006-1860
(202) 778-8823

Of Counsel

MILBANK, TWEED, HADLEY & McCLOY
1825 Eye Street, N.W.
Suite 900
Washington, D.C. 20006
(202) 835-7500

Mark A. Kantor
Lorraine S. McGowen

Exhibit 3

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D. C.

Joint Application of

AMERICAN AIRLINES, INC,

and

TRANS WORLD AIRLINES, INC.

for approval of transfer of
certificates under Section 401(h)

Docket 47320

Joint Application of

UNITED AIRLINES, INC.

and

PAN AMERICAN WORLD AIRWAYS, INC.

for approval of transfer of
certificates under Section 401(h)

Docket 47237

ANSWER OF MARION KINDIG TO THE DEPARTMENT OF TRANSPORTATION'S TENTATIVE APPROVAL OF JANUARY 8, 1991, OF THE TRANSFER OF PAN AMERICAN WORLD AIRWAYS, INC.'S LONDON ROUTES TO UNITED AIRLINES, INC.

Communications with respect to
this document should be sent to:

MARION KINDIG
President - R. O. B.
P. O. Box 15503
Washington, D. C. 20003
(202) 544-1400

Dated: January 18, 1991

Section 401(h)(1) provides that a certificate may only be transferred if it is determined to be in the public interest.

Section 401(h)(2) provides that the Secretary of Transportation is required, upon any transfer of a certificate, to certify to the Committee on Commerce, Science and Transportation of the Senate and the Committee on Public Works and Transportation of the House of Representatives that the transfer is consistent with the public interest. In the instant case, it would be impossible for the Secretary of Transportation to certify, in good faith, to the aforementioned Committees that the proposed route transfer would, in fact, be in the public interest.

BACKGROUND OF THE CASE

Starting in approximately 1980, Pan American World Airways, Inc., (hereinafter called Pan Am), has consistently underfunded and plundered its' employee pension plans, in violation of the applicable ERISA laws, and in violation of the applicable IRS Code -- in particular U.S.C.S.26 §412 and §412(d).

On January 8, 1991, Pan Am filed for Chapter 11 and dumped its $800 million pension liability (according to PBGC figures) into the lap of the Pension Benefit Guaranty Corporation, which insures the pension plans of approximately 39 million Americans.

A major problem is that the PBGC is itself woefully underfunded, with Congressman Armey stating in a WALL STREET JOURNAL article that the underfunding is estimated at $17 billion. The former Inspector General of the Department of Labor, Mr. Raymond Maria, has likened the pension situation to a scandal that will dwarf the S & L crisis when it comes to light. The Justice Department stated in a Supreme Court brief in the LTV case, that the

PBGC "is in dire financial straits". And the PBGC's own Executive Director, Mr. James Lockhart, stated in the same Supreme Court case that the nation's pension insurance system is sliding toward general default, which will lead to a financial crisis similar to the savings-and-loan breakdown.

At the present time, the premiums for PBGC insurance are paid for by employers whose plans are insured by the PBGC, with the rates being $16.00 per employee for the plans meeting the minimum funding standards, to $50.00 per employee per year for the most underfunded plans. In a Justice Department brief, it was stated that it would not be feasible to raise the rates, because it would tend to cause employers with well-funded plans to drop out of the system.

WHY THE PAN AM-UNITED LONDON ROUTE TRANSFER WOULD NOT BE IN THE PUBLIC INTEREST

1. United Airlines has offered to buy Pan Am's London routes and Pan Am's round-the-world authority (former PAA Flt. 1 and PAA Flt. 2) for the fire-sale price of $400 million. Delta, TWA and Tri-Cinda Corporation have offered to bid for Pan Am's assets at what appears to be considerably higher prices. It is not in keeping with common business practice to have the low bidder consummate the sale. It should therefore be left open to allow the highest bidder to receive the assets.

2. The PBGC requested that Pan Am's London routes and other assets go to the highest bidder, and have the resulting monies put into Pan Am's woefully underfunded pension plans. The more that is obtained from the sale of Pan Am's assets and put into the disasterously underfunded pension plans, the more it will reduce the $800 million pension underfunding. Pan Am is

not the only financial basket case coming down the pike, and like the FSLIC before it, the PBGC is hanging on by its finger nails. Consequently, the more that is received from the sale of Pan Am's assets, and the more that is put into the underfunded Pan Am pension plans, the lower will be the ultimate cost to the hapless taxpayer. Just recently, the PBGC has also had Eastern's $1.5 billion underfunded pension plans dropped into its lap. The massive underfunding of the nation's pension plans (in violation of the applicable laws) is a national disaster waiting to happen. See as Exhibit "A" the PBGC's list of the 50 most underfunded pension plans -- which reads like the Fortune 500. It should also be noted that when a plan terminates and goes to the PBGC, the beneficiaries immediately lose all of their hospitalization, medical, dental, vision, prescription, etc., benefits -- as these are not covered by the PBGC. Also, the cash payments are generally reduced from what was contracted for. See as Exhibit "B" the case of Richard Cecconi (testimony before Senator Howard Metzenbaum) where he ended up receiving only 27% of the pension monies he had been receiving prior to the plans going to the PBGC.

3. The aforementioned route transfer would diminish Pan Am's base and cause it to be less likely to pay its contracted for pension benefits. As Pan Am shrinks ever smaller, its ability to pay for the unfunded liabilities in the pension plans grows ever dimmer -- and the heightened cost to the taxpayer grows ever more imminent.

4. When Pan Am and United applied to the DOT for the Pacific route transfer, certain representations were made to the DOT by both carriers -- upon which representations the route transfer was granted. After the granting of the route transfer,

both Pan Am, and in particular United, proceeded to blatantly breach and violate those representations. In the unholy alliance of Pan Am and United created by the 1986 Pacific route transfer, there were deals, acts and transactions between Pan Am and United which will be more than shocking when they are brought to light. Since neither Pan Am or United have acted as good corporate citizens in the past, there is little reason to believe that they will do so in the future.

5. Delta does not appear on the PBGC's 50 most underfunded list -- whereas United does with only 50.4% funded. This appears to be in violation of both 26 U.S.C.S §412 and §412(d). Although United is earning money at this point in time, no one knows what the future will hold. Therefore, United's pension plans may one day become another taxpayer bailout. If United has $400 million to spare, it would be more in the public interest to have that money used to refund its horrendously underfunded pension plans -- as well as more in keeping with the applicable pension and IRS laws.

6. It would definitely be in the public interest to first hold an oral-evidentiary hearing to determine how Pan Am's pension plans got to be underfunded by $800 million in violation of the applicable laws, before deciding upon any route transfer and first determining which would be the best avenue to take in the public interest. A special prosecutor needs to be assigned by the appropriate Senate committee to determine what has occurred and whether there should be criminal sanctions, most particularly regarding a leasehold transaction which was akin to selling the Brooklyn Bridge into the pension plans at a cost to the plans of $167.9 million. Also, as a result of this transaction, the employee's pension plans are liable to the New York Port Authority

for Pan Am's rent payments for the next 8 years should Pan Am default on its payments.

7. Under Section 401(h)(2), the Secretary of Transportation must, along with certification to the Senate and House, issue a report analyzing the effects of the transfer on the viability of each of the carriers in the transaction. This transaction will greatly diminish Pan Am's route structure, and consequently, greatly diminish its viability. The Secretary of Transportation could not, there, in good conscience, certify to the Committee on Commerce, Science and Transportation of the Senate and the Committee on Public Works and Transportation of the House of Representatives, that the transfer is consistent with the public interest.

8. The Secretary's June, 1989, letter identified several important policy issues that are to be evaluated when the Department considers the transfer of limited entry international route authority, including:

a. whether the proposed transfer undercuts the important public benefits that the Department sought to achieve by awarding the route in the first place. (This proposed transfer would definitely undercut the important public benefits that the Department has sought in the past in that it would greatly eliminate the competition which the Department has consistently sought to achieve. It would in effect greatly lead to creating 2 super carriers -- namely United and American -- and is definitely not in the public interest.)

b. whether the proposed transfer will significantly diminish the ability of a carrier to remain an effective competitor in the airline industry.

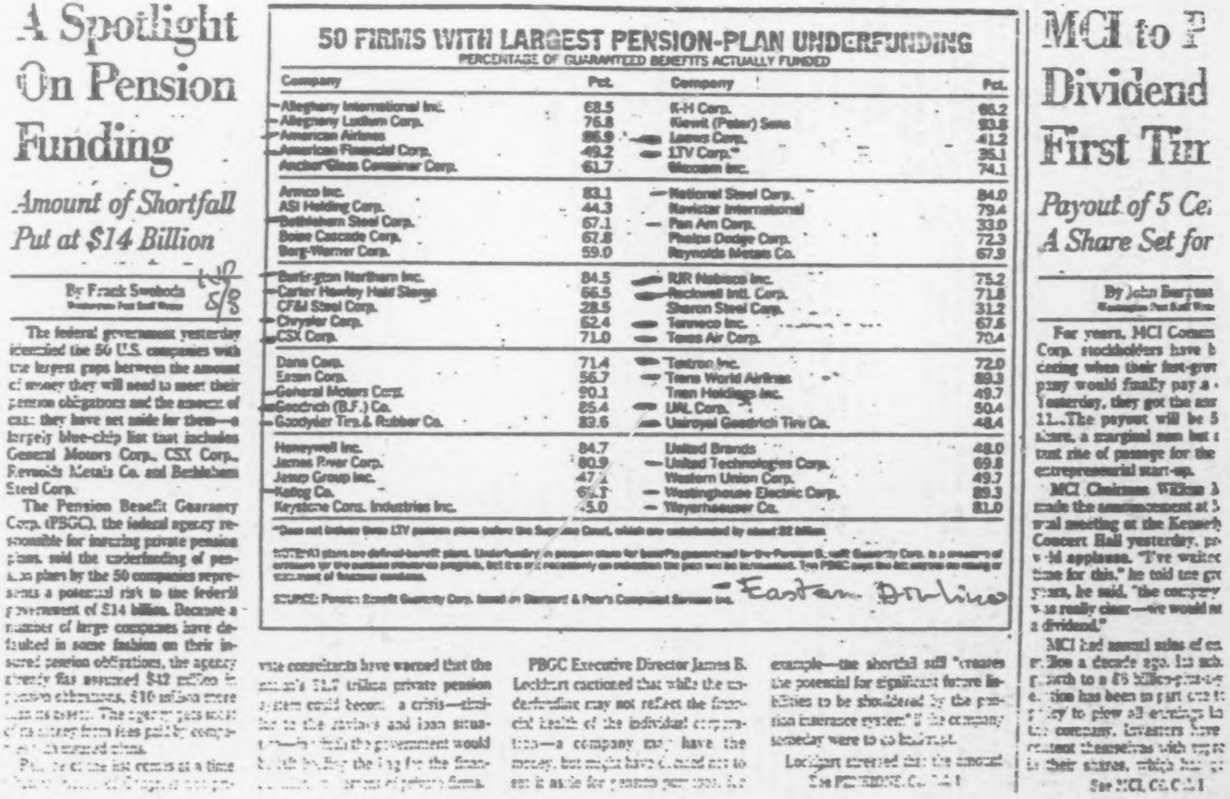
(The proposed route transfer will so dramatically undercut Pan Am's route structure, that it will totally diminish Pan Am's ability to remain an effective competitor in the airline industry.)

c. whether the proposed transfers will undercut the important public benefits that the Department sought to achieve by awarding these routes in the first place.

(The proposed transfers are not consistent with the the Department's policy of creating a competitive environment, and are not in the public interest.)

WHEREFORE, I pray that for all of the aforementioned reasons United's fire-sale price of $400 million for Pan Am's routes be denied; that the routes, and possibly other assets of Pan Am, be sold to the highest bidder; that the monies derived therefrom be put into Pan Am's underfunded pension plans in the public interest so as to minimize the impact upon the taxpayers; that there be an oral-evidentiary hearing in order to determine and carefully explore which of several options would be in the best interests of the public as regards minimizing the taxpayer bailout - the viability of Pan Am after the route transfer - whether the route transfer would greatly eliminate the competition which the Department has consistently sought to achieve - whether the proposed transfer will so dramatically undercut Pan Am's route structure that it will totally diminish Pan Am's ability to remain an effective competitor in the airline industry - and whether the transfer (if granted to United) would create 2 super carriers.

Exhibit "A" Total Plan Underfunding
$40 Billion



A Spotlight On Pension Funding

Amount of Shortfall Put at $14 Billion

By Frank Swoboda
Washington Post Staff Writer

8/8

The federal government yesterday identified the 50 U.S. companies with the largest gaps between the amount of money they will need to meet their pension obligations and the amount of cash they have set aside for them—a largely blue-chip list that includes General Motors Corp., CSX Corp., Reynolds Metals Co. and Bethlehem Steel Corp.

The Pension Benefit Guaranty Corp. (PBGC), the federal agency responsible for insuring private pension plans, said the underfunding of pension plans by the 50 companies represents a potential risk to the federal government of $14 billion. Because a number of large companies have defaulted in some fashion on their insured pension obligations, the agency already has assumed $4[illegible] in pension obligations, $[illegible] more than its assets. The agency gets most of its money from fees paid by companies with insured plans.

Release of the list comes at a time [illegible] vate consultants have warned that the nation's $1.7 trillion private pension system could become a crisis—similar to the savings and loan situation—in which the government would be left holding the bag for the financial [illegible] of private firms.

PBGC Executive Director James B. Lockhart cautioned that while the underfunding may not reflect the financial health of the individual corporation—a company may have the money, but might have decided not to set it aside for pension purposes, for example—the shortfall still "creates the potential for significant future liabilities to be shouldered by the pension insurance system" if the company someday were to go bankrupt.

Lockhart stressed that the amount

See PENSIONS, C[illegible], Col. 1

50 FIRMS WITH LARGEST PENSION-PLAN UNDERFUNDING

PERCENTAGE OF GUARANTEED BENEFITS ACTUALLY FUNDED

Company	Pct.	Company	Pct.
Allegheny International Inc.	68.5	K-H Corp.	66.2
Allegheny Ludlum Corp.	76.8	Kiewit (Peter) Sons	93.8
American Airlines	86.9	Loews Corp.	41.2
American Financial Corp.	49.2	LTV Corp.*	35.1
Anchor Glass Container Corp.	61.7	Maxxam Inc.	74.1
Armco Inc.	83.1	National Steel Corp.	84.0
ASI Holding Corp.	44.3	Navistar International	79.4
Bethlehem Steel Corp.	67.1	Pan Am Corp.	33.0
Boise Cascade Corp.	67.8	Phelps Dodge Corp.	72.3
Borg-Warner Corp.	59.0	Reynolds Metals Co.	67.9
Burlington Northern Inc.	84.5	RJR Nabisco Inc.	75.2
Carter Hawley Hale Stores	66.5	Rockwell Intl. Corp.	71.8
CF&I Steel Corp.	28.5	Sharon Steel Corp.	31.2
Chrysler Corp.	62.4	Tenneco Inc.	67.6
CSX Corp.	71.0	Texas Air Corp.	70.4
Dana Corp.	71.4	Textron Inc.	72.0
Exxon Corp.	56.7	Trans World Airlines	89.3
General Motors Corp.	90.1	Tran Holdings Inc.	49.7
Goodrich (B.F.) Co.	85.4	UAL Corp.	50.4
Goodyear Tire & Rubber Co.	83.6	Uniroyal Goodrich Tire Co.	48.4
Honeywell Inc.	84.7	United Brands	48.0
James River Corp.	80.9	United Technologies Corp.	69.8
Jesup Group Inc.	47.[illegible]	Western Union Corp.	49.7
Kellog Co.	6[illegible]	Westinghouse Electric Corp.	89.3
Keystone Cons. Industries Inc.	[illegible]5.0	Weyerhaeuser Co.	81.0

*Does not include three LTV pension plans before the Supreme Court, which are underfunded by about $2 billion.

NOTE: All plans are defined-benefit plans. [illegible]

SOURCE: Pension Benefit Guaranty Corp. based on Standard & Poor's Compustat Services Inc.

—Eastern Airlines

MCI to P
Dividend
First Tim

Payout of 5 Ce
A Share Set for

By John Burgess
Washington Post Staff Writer

For years, MCI Comm
Corp. stockholders have b
ciding when their fast-grow
pany would finally pay a
Yesterday, they got the ans
11. The payout will be 5
share, a marginal sum but a
tant rite of passage for the
entrepreneurial start-up.

MCI Chairman William
made the announcement at
nual meeting at the Kennedy
Concert Hall yesterday, pr
wild applause. "I've waited
time for this," he told the gr
years, he said, "the company
was really clear—we would n
a dividend."

MCI had annual sales of
million a decade ago. Its sub
growth to a $5 billion-plus
[illegible] has been in part due to
policy to plow all earnings ba
the company. Investors have
content themselves with appre
in their shares, which have g

See MCI, C6, Col. 1

Exhibit B

NSIONS: irms Gamble With Benefits

Continued from A14

tributions to the plans. The airline was also obligated to pay the plans $2.8 million a month in rent for the terminal.

At a Labor Department hearing on the transfer last May, Lilly and Pan Am officials described the transfer as beneficial to the pension plans and painted a grim picture of the alternatives.

Without the transfer, Pan Am would have to pay the funds $127 million in contributions in 1989, an amount that exceeded the company's cash balance, said its treasurer, David Davies.

Companies in financial distress can obtain waivers of pension fund contributions from the IRS. The IRS has been criticized for being too generous with its waivers, but the alternative is often the shutdown of a plant.

The law limits the number of waivers that a company can receive in a 15-year period, and Pan Am was already at the limit. It had been allowed to withhold more than $200 million in payments since 1981.

Critics of the deal said at the hearing that Pan Am probably would not be good for its required monthly rent payments of $2.8 million if it went bankrupt. They pointed out that the lease would represent 29% of the pension plans' assets, a high proportion given the mandate that plan funds be diversified to ensure their safety.

Yet the only union to oppose the deal was the Teamsters, who have been engaged in protracted negotiations with Pan Am on other issues. Representatives of other workers described the transaction as an alternative to bankruptcy.

"I think that a majority, a vast majority, of the employees at Pan American would rather keep their jobs than lose their jobs," said Tom Lambert, who represented 1,200 active and retired flight-crew members.

The union for Pan Am's 5,000 flight attendants did not speak out on the transaction because, as union official Brian K. Moreau said, "We felt it was damned if you do the deal and damned if you don't."

The Labor Department approved the transfer in August. The PBGC was not officially involved, but because it will have to pay off the pensions if Pan Am goes bankrupt, Lockhart said that the agency was aware of what was happening.

The bottom line is that, if the gamble pays off and Pan Am survives, the lease transaction will be heralded as a great deal. If the airline goes under anyway, the PBGC will probably have to cover the $85.6 million in cash that the plans returned to Pan Am as well as several hundred million dollars more in underfunded pensions.

Workers With Best Benefits Stand to Lose Most

By DOUGLAS FRANTZ
TIMES STAFF WRITER

WASHINGTON—Richard E. Cecconi retired on March 31, 1986, after 30 years with Republic Steel in Warren, Ohio. He was 50, his pension was $2,300 a month and his retirement looked secure.

Then Republic's parent, Dallas-based LTV Corp., declared bankruptcy, and the federal Pension Benefit Guaranty Corp. took over LTV's underfunded pension plans in the biggest pension bailout ever.

Cecconi and thousands of other LTV workers learned what pension rights advocates have long warned—workers with the best pension benefits stand to lose the most when the PBGC moves in. Cecconi's pension was cut to $632 a month.

"There is no fairness here," Cecconi said. "I was not an early retiree. I worked the full 30 years necessary to qualify for a full pension, and now get only 27%."

But without the PBGC, Cecconi and 108,000 other LTV workers and retirees would have gotten far less.

"The main purpose of the PBGC was to make sure that people didn't see their pensions totally wiped out, and it has been a very definite success," said Alan V. Reuther, associate general counsel at the United Auto Workers. "As difficult as LTV was, it would have been a complete disaster without the PBGC."

The agency was created by Congress in 19 part of a package of pension-protection mea known as the Employee Retirement Income S rity Act. Its mission was similar to that of Federal Deposit Insurance Corp., which ins bank deposits up to $100,000 per account.

When the PBGC becomes trustee of a per plan that does not have enough money to pa obligations, the agency pays the pensions up certain maximum. The ceiling was $750 a mon 1974 and has risen to $2,028 for 1989.

The agency guarantees only basic ben available at age 65 under the company plan. T who retire before 65, such as Cecconi, receive under a formula. For instance, a worker who t early retirement at 55 will receive about hal PBGC maximum.

The agency does not guarantee health welfare benefits, and pension increases grantc the company in the five years before the ended are reduced according to a formula.

The PBGC insures the pensions of 40 mi workers and retirees covered by defined-be plans, the type promising a specific amount b on age, service and salary. Another 36 mi workers have defined-contribution plans, suc profit-sharing and 401(k) savings plans, whic not insured.

PROOF OF SERVICE

I, Marion Kindig, declare as follows:

1. I reside in Washington, D. C.

2. I am over the age of 18 years. My mailing address is P. O. Box 15503, Washington, D. C. 20003.

3. I served the following on January 18, 1991:

ANSWER OF MARION KINDIG TO THE DEPARTMENT OF TRANSPORTATION'S TENTATIVE APPROVAL OF JANUARY 8, 1991, OF THE TRANSFER OF PAN AMERICAN WORLD AIRWAYS, INC.'S LONDON ROUTES TO UNITED AIRLINES, INC.

by causing one copy enclosed in a sealed envelope with postage thereon fully prepaid to be deposited in the United States Postal Depository in Washington, D. C., addressed to:

Mr. John E. Gillick
Winthrop, Stimson, Putnam & Roberts
1133 Connecticut Avenue, N. W., Suite 1200
Washington, D. C. 20036

and an additional copy was served on each party listed on the "Service List" attached hereto as Exhibit "a".

I declare under penalty of perjury that the foregoing is true and correct.

Marion Kindig
MARION KINDIG

Exhibit "A"

SERVICE LIST

Carl B. Nelson
American Airlines, Inc.
1101 17th Street, N.W.
Suite 600
Washington, D.C. 20036

Ronald D. Eastman
Cadwalader, Wickersham
& Taft
Northwest Airlines, Inc.
1333 New Hampshire Ave., N.W.
Suite 700
Washington, D.C. 20036

Richard B. Jamison
Director of Airport
Detroit Metropolitan Wayne
County Airport
L.C. Smith Terminal
Detroit, MI 48242

Jonathan Blank
Preston, Gates, Ellis
& Rouvelas Meeds
1735 New York Ave., N.W.
Suite 500
Washington, D.C. 20590

Stephen L. Gelband
Hewes, Morella, Gelband
& Lamberton
1000 Potomac Street, N.W.
Washington, D.C. 20007

Ambassador, British Embassy
3100 Massachusetts Ave., NW
Washington, D.C. 20008

Charles Angevine
Department of State
Office of Aviation
2201 C Street, N.W.
Washington, D.C. 20590

Robert Cohn
Shaw, Pittman, Potts
& Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037

Bruce Keiner
Crowell & Moring
1001 Pennsylvania Ave., NW
10th Floor
Washington, D.C. 20004

Michael Roberts
Verner, Liipfert, Bernhard,
McPherson & Hand
901 15th Street, N.W.
Suite 700
Washington, D.C. 20005

William Alberger
Bishop, Cook, Purcell
& Reynolds
1400 L Street, N.W.
Washington, D.C. 20005

Paul M. Donovan
LaRoe, Winn, Moerman
& Donovan
1120 G Street, N. W.
Suite 800
Washington, D.C. 20005

James Wilding
General Manager
Metropolitan Washington
Airports Authority
National Airport
Washington, D.C. 20001

Jay Franke, Commissioner
Chicago Department of Aviation
20 N. Clark Street
Suite 300
Chicago, IL 60602

Louis A. Turpen
Director - Airports
San Francisco Intl. Airports
P. O. Box 8097
San Francisco, CA 94128

Jerome A. Montgomery
Assistant City Attorney
City Attorney's Office
Department of Airports
1 World Way, Room 104
P. O. Box 92216
Los Angeles, CA 90009-2216

Frederick A. Elder
Peter Reaveley
Dade County Aviation Department
Miami Intl. Airport
P. O. Box 592075 AMF
Miami, FL 33159

Elliott M. Seiden
Vice President Law and
Government Affairs
Northwest Airlines, Inc.
901 15th Street, N.W.
Suite 300
Washington, D.C. 20005

Wesley Kennedy
Cotton, Watt, Jones & King
122 South Michigan Avenue
Suite 2050
Chicago, IL 60603

Kenneth A. Rowe
Virginia Department of
Aviation
4508 South Laburnum Ave.
Richmond, VA 23231

Vincent Tese
Commissioner, Department of
Economic Development
State of New York
1515 Broadway
New York, NY 10036

Michael F. Goldman
Steele, Goldman & Silcox
2020 K Street, N.W.
Suite 850
Washington, D.C. 20006-1806

George N. Kenyon
Associate General Counsel
Trans World Airlines, Inc.
100 South Bedford Road
Mt. Kisco, NY 10549

R. Daniel Devlin
Staff Vice President-
Legislative Affairs
Trans World Airlines, Inc.
808 17th St., NW, Suite 520
Washington, D.C. 20006

David A. Borer, Director
Collective Barganing
Ben Elliott
Association of Flight
Attendants
1625 Massachusetts Ave. NW
Washington, D.C. 20036

Stephen B. Moldof
Cohen, Weiss and Simon
330 West 42nd Street
New York, NY 10036

Denis F. Gordon
Gordon & Barnett
1133 21st Street, N.W.
Suite 450
Washington, D.C. 20036

Frank Cotter
Assistant General Counsel
Legal Department
USAir
Crystal Park Four
235 Crystal Drive, 8th Flr.
Arlington, VA 22227

Peter O. Shinevar
Bredhoff & Kaiser
1000 Connecticut Ave. NW
Suite 1300
Washington, D.C. 20036

R. Russell Bailey
Air Line Pilots Association
International
1625 Massachusetts Ave. N.W.
Washington, D.C. 20036

Marshall S. Sinick
Squire, Sanders & Dempsey
1201 Pennsylvania Avenue, N.W.
Suite 500
Washington, D.C. 20044

Patrick J. Riley
International Brotherhood
of Teamsters
25 Louisiana Avenue, N.W.
Washington, D.C. 20001

Charles Kurth
Kurth & Co., Inc.
4400 MacArthur Blvd., N.W.
Suite 303
Washington, D.C. 20007

Joe Sims
Jones Day Reavis & Pogue
1450 G Street, N.W.
Suite 600
Washington, D.C. 20005

Arthur M. Luby
O'Donnell, Schwartz
& Anderson
1300 L Street, N.W.
Suite 200
Washington, D.C. 20005

Claire Shulman
President, Borough of Queens
120-55 Queens Boulevard
Kew Gardens, New York 11424

Exhibit 4

BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.

Joint Application of

UNITED AIR LINES, INC.
and
PAN AMERICAN WORLD AIRWAYS, INC.

for certificate transfer under
Section 401(h) of the Federal
Aviation Act of 1958, as amended

Docket 47237

JOINT ANSWER OF PAN AMERICAN WORLD AIRWAYS, INC. AND UNITED AIR LINES, INC. TO OBJECTIONS TO ORDER 91-1-11

Communications with respect to this document should be sent to:

RICHARD D. MATHIAS
Senior Vice President
Government Affairs
PAN AMERICAN WORLD AIRWAYS, INC.
1200 17th Street, N.W.
Suite 500
Washington, D.C. 20036
(202) 659-7730

LAWRENCE M. NAGIN
Senior Vice President -
Corporate Affairs &
General Counsel
UNITED AIR LINES, INC.
P.O. Box 66100
Chicago, IL 60666
(708) 952-4365

WILLIAM T. COLEMAN, JR.
DONALD T. BLISS
O'MELVENY & MYERS
555 13th Street, N.W.
Suite 500 West
Washington, D.C. 20004
(202) 383-5325

JOEL STEPHEN BURTON
GINSBURG, FELDMAN AND BRESS,
CHARTERED
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036
(202) 637-9130

Dated: January 22, 1991

**BEFORE THE
DEPARTMENT OF TRANSPORTATION
WASHINGTON, D.C.**

Joint Application of

UNITED AIR LINES, INC.
and
PAN AMERICAN WORLD AIRWAYS, INC.

for certificate transfer under
Section 401(h) of the Federal
Aviation Act of 1958, as amended

Docket No. 47237

JOINT ANSWER OF PAN AMERICAN WORLD AIRWAYS, INC. AND UNITED AIR LINES, INC. TO OBJECTIONS TO ORDER 91-1-11

Pan American World Airways ("Pan Am") and United Air Lines, Inc. ("United") are submitting this Joint Answer to the objections filed to Order 91-1-11, which proposed to approve the transfer to United of certain of Pan Am's transatlantic route authority.

1. The Department's approval of this transaction by January 25, 1991 is crucial to Pan Am. The Bankruptcy Court has scheduled a hearing on that date to consider final approval of a Credit Agreement between Pan Am and Bankers Trust Company pursuant to which Pan Am may borrow up to $150 million to help finance its on-going operations pending the closing of its route transfer agreement with United. At a hearing on January 10, 1991, the Bankruptcy Court granted interim approval of the Credit

Agreement, allowing Pan Am to draw down $50 million of the loan, which it has done. Under the terms of the Credit Agreement, Pan Am's ability to borrow additional funds is subject to two principal conditions: Final approval of the Credit Agreement by the Bankruptcy Court and the Department's having issued a final order approving the United/Pan Am route transfer. As noted, the Bankruptcy Court will hold a hearing to consider final approval of the Credit Agreement on January 25, and the Court is expected to enter its decision that day. However, for Pan Am to borrow additional funds on that date, the Department also must have issued a final order approving the United/Pan Am route transfer.1/

Pan Am's ability to draw down additional funds is critical to its continued operations. The war in the Gulf has severely disrupted international air travel, placing substantial additional financial pressures on Pan Am's limited cash reserves. Pan Am's ability to continue operations beyond January 25 is,

---

1/ There is no requirement in the Credit Agreement for the United Kingdom to have approved United's substitution for Pan Am at Heathrow Airport before Pan Am can borrow the remaining $100 million. Notably, however, on January 22, 1991, the U.K.'s Civil Aviation Authority ("CAA") released its "Advice to the Secretary of State for Transport" in which it "concludes ~~that little~~ purpose would be served in continuing to interpret [U.K. London Airport Traffic Distribution Rules] so as to exclude the direct replacement of qualifying airlines if they are nominated by their Governments, and, indeed that it would be unrealistic to do so." CAA, The Need for Traffic Distribution Rules, CAP 598, para 3.4.

therefore, directly linked to its ability to borrow additional sums from Bankers Trust should its existing cash reserves prove inadequate.

2. Only two airlines -- Delta Air Lines and America West Airlines -- oppose the Department's tentative approval of the route transfer.[2] Neither, however, has demonstrated any error in the decision nor provided any justification for the Department's not making its tentative findings and conclusions final by January 25, 1991.

America West's objection requires no elaborate refutation. Its demand for an oral evidentiary hearing was thoroughly considered and rejected by the Department in Order 91-1-4. Its objections to the Department's tentative findings relating to Pan Am's viability and its concerns about the effect of the transfer on industry balance and on-going bilateral discussions with the United Kingdom merely echo previously rejected arguments and identify no error in the Department's findings.

---

[2] Comments also were filed by American Airlines and Trans World Airlines. Neither objects to any of the tentative findings in Order 91-1-11. Rather, each carrier uses its comment to urge delay in the approval of the United/Pan Am transaction until the Department commits to prompt approval of their own later-filed route transfer application pending in Docket 47237 through expedited show cause procedures. American also argues that the Department should not approve the transfer to United of any Pan Am route which is the subject of a competing application and motion to consolidate with the American/TWA route transfer, until the Department denies such request, citing the so-called Ashbacker doctrine. See American's Answer at 2-4. The outcome of the TWA/American route transfer (and the procedures to be used) should be decided on their own merits. Delaying approval of the United/Pan Am route transfer, which has been pending before the Department since November 1, is neither consistent with the public interest nor required to assure TWA and American due process. Indeed, as explained in the text at pages 1-2, supra, delay could have serious adverse consequences for Pan Am.

It is axiomatic that the revitalization of Pan Am would better serve the public interest than would the dismemberment of the carrier.[3] Yet, the procedural delay America West urges can have only one outcome -- Pan Am's rapid demise. As previously noted, Pan Am's continued operations are directly linked to the Credit Agreement with Bankers Trust, which is, in turn, directly linked to final approval of the route transfer by DOT. Once the United agreement closes, Pan Am will obtain $290 million of cash proceeds, and a comprehensive marketing agreement with United that includes interline schedule coordination, reciprocal frequent flyer program participation and limited code sharing. Pan Am will also receive a $100 million travel agent ticket guarantee, which will help maintain public confidence in the carrier.

Pan Am has evaluated these agreements and concluded that (1) reciprocal frequent flyer participation alone should generate incremental revenue for the carrier of over $100 million annually and (2) the other agreements should produce additional millions of dollars of increased revenues. See, e.g., Pan Am Doc. No. P020226-227. The funds Pan Am will receive from United and the carriers' marketing alliance, coupled with Pan Am's revised business plan, which involves the carrier refocusing its international operations on Latin America and Central Europe through its hubs at Miami, New York, Los Angeles and Frankfurt, may be the only real opportunity for Pan Am in the current circumstances to remain an effective competitor in key Latin America and transatlantic markets, as the Department tentatively concluded. America West's nominal objection questioning whether Pan Am can remain viable rings hollow since it provides neither a basis for the Department to conclude that Pan Am's revised business plan will not succeed, nor a reason for the Department to reconsider its tentative findings or conclusions. Rather, it suggests a lengthy procedure that would inevitably result in transforming its concern into a self-fulfilling prophecy.

---

[3] This was recognized by the Bankruptcy Court in its interim approval of the Bankers Trust Credit Agreement on January 10 and in its approval of the United/Pan Am route transfer agreement at the same hearing.

America West's other objections stand on no better ground. The Department has already fully considered its comments on industry balance and domestic competition and has found them to be without merit in the circumstances of this route transfer proceeding. America West's speculation about the possible outcome of the on-going consultations with the United Kingdom over U.S. carrier services at Heathrow Airport is just that. In effect, America West is challenging the Department's conclusion in Order 91-1-4 that any agreement with the United Kingdom would be consistent with the public interest. See Order 91-1-4 at 6-7. America West offers nothing to support its contention that the Department has not already considered and rejected.

3. Delta's belated objection is no more persuasive.[4] The transparent predicate for the objection is Delta's self-serving interest in obtaining Pan Am's Los Angeles-London route. But Delta's interest in purchasing this route comes too late. The Bankruptcy Court already has approved the United/Pan Am route transfer agreement, finding that the agreement benefits Pan Am, its creditors and its employees. The Court did so despite Delta's belated suggestion that it might be prepared to pay $50 million for the route. In any event, the Department has no jurisdictional basis to direct Pan Am to sell the Los Angeles-London route to Delta, as Delta appears to propose (p. 13). In fact, what Delta is really asking the Department to do is to sever the Los Angeles route from the transaction and to set down a carrier selection proceeding to choose a replacement for Pan Am on the route. Such action by the Department would not benefit Pan Am or its estate; it would, however, undo the United/Pan Am route transfer agreement, and deny Pan Am funds essential to finance its new business plan, undermining its ability to reorganize successfully and remain an effective industry participant.

---

[4] Although the Department has afforded interest persons an extended period to comment on the United/Pan Am application, Delta failed to raise its objection in an answer prior to the Department's issuance of a Show Cause Order proposing approval. Delta offers no explanation for its tardiness in raising its objection.

Moreover, Delta's proposal contravenes the Department's established policy not to entertain competing route applications in certificate transfer cases.[5] See Braniff South American Route Transfer Case, Order 82-9-81. See also Orders 91-1-12 and 90-4-11. Delta has provided no rationale for the Department to deviate from that policy here. Beyond mere ipse dixit, Delta has failed utterly to establish that the transfer to United of Pan Am's three West Coast gateways could "reduce, if not eliminate intergateway competition in the region."[6] Objection at 14. Pan Am today is certificated for and operates to London from all three West Coast gateways; transferring the gateways to United, which operates no United Kingdom service at present, is competitively neutral at worst and should, in fact, greatly enhance intergateway competition throughout the country. Significantly, on January 17, 1991, the Joint Applicants were notified that the Department of Justice had completed its antitrust review of the proposed transaction and granted early termination of the HSR waiting period.

---

[5] In explaining its basic approach to route transfers, the Department has indicated that it will not use the filing of a route transfer application as an opportunity to "'fine tune'" competition in the affected areas. Order 90-4-11 at 10.

[6] Delta's further suggestion that "United will be the dominant U.S.-flag carrier serving the limited-entry United Kingdom market...." is absurd. (Objection at 11, emphasis in original.) During the 1990 peak summer season, Pan Am's service over the routes being transferred to United accounted for only 13.7% of the total seats and 10.7% of the total roundtrip frequencies operated weekly between the United Kingdom and the United States. While United intends to increase frequencies over certain of the routes, this should not cause a significant increase in these percentages because of the frequency limitations in the bilateral. See Exhibit UA-870 in Docket 47090.

Four carriers currently provide nonstop Los Angeles-London service, making it the second-most competitive gateway between the U.S. and the United Kingdom. Transferring Pan Am's authority at Los Angeles to United will not change the number of carriers operating nonstop over the route, although it will increase the total number of carriers competing in the market since Pan Am will continue to serve the market via its Miami gateway. However, if the Los Angeles gateway were transferred to Delta, there would be a loss of competition since Delta already serves the market on a connecting basis via its hubs at Atlanta and Cincinnati. Further, passengers originating at non-gateway points in the Western region of the country have convenient access to numerous other interior and eastern gateways for United Kingdom travel.7/ Finally, because Pan Am will retain two U.S.-London gateways, the effect of the transaction will be to add an additional U.S.-flag competitor and thereby increase intergateway competition.

7/ This is amply demonstrated by the experience at Fresno, cited by Delta (p. 10) as a community likely to suffer a severe anticompetitive effect if the route transfer is approved. According to the Department's O&D survey, during the 12 months ended June 30, 1990, there were a total of 540 roundtrip Fresno-London passengers. While 52% of these passengers did travel via the Los Angeles gateway, a greater percentage traveled via Delta's gateways at Atlanta and Cincinnati than traveled via San Francisco, and none traveled via Seattle.

4. Of the several Pan Am and United unions, the only extended response to the Order to Show Cause was filed by Pan Am's Independent Union of Flight Attendants ("IUFA"). IUFA inaccurately claims that imposition of labor protective provisions ("LPPs") is necessary to prevent the loss of jobs, and once again asks the Department to forego its oft-stated policy of deferring to the normal collective bargaining process with regard to labor protection.

As we have shown in our prior pleadings, IUFA's position is inconsistent with the facts on both counts. First, no jobs need be lost as a result of this transaction. If appropriate arrangements can be made between IUFA and United's flight attendants union, then a reasonable number of Pan Am flight attendants will transfer with seniority credit. If such arrangements cannot be made, then those more senior Pan Am flight attendants will continue to work for Pan Am, and if any junior Pan Am flight attendants are "excessed" by Pan Am during 1991, they will be eligible for expedited employment consideration by United. While the latter group of junior Pan Am flight attendants would be hired without seniority credit, they should be in no worse position because United's rates of pay and benefits are superior to those at Pan Am.[8/]

[8/] IUFA maintains these "commitments" by United are of little benefit to IUFA's members. In attempting to buttress this contention, IUFA alleges that United failed to comply with similar commitments following United's acquisition of Pan Am's Pacific Division. As IUFA should know, this assertion is inaccurate. In the Pacific Division transfer agreement, United committed to hiring a total of 1,202 fully (footnote continued)

Second, IUFA is wrong in describing the alleged futility of the normal collective bargaining process. While IUFA is correct that it cannot compel United, or United's flight attendant union (the Association of Flight Attendants), to bargain, IUFA was and is able to bargain with Pan Am. In particular, IUFA could have sought to obtain pre-transaction protections from Pan Am -- such as no furlough rules or restrictions on asset sales only to buyers who would agree to labor terms acceptable to IUFA. The fact that IUFA did not succeed in obtaining such pre-transaction protection at the bargaining table, and instead obtained labor protection in the form of supplemental severance pay, should not now be the basis for post-transaction governmental intervention.

(footnote continued from previous page)
qualified Pan Am flight attendants, which it did. The Kindig litigation referred to by IUFA did not involve United's adherence to the labor commitments contained in its acquisition agreement with Pan Am, but to a claim by Ms. Kindig that she should have been one of the specific attendants hired. In resisting such claim, United maintained, inter alia, that individual Pan Am employees who were dissatisfied with the selection process lacked standing to sue United. This hardly establishes that these commitments "promise little" for IUFA's members.

In summary, the Department must decline IUFA's invitation to depart from well-established Department policy regarding LPPs. This case well illustrates the soundness of the Department's decision to defer the subject of labor protection to the normal collective bargaining process.

* * * * *

None of the responses to Order 91-1-11 raises an issue or objection that has not been addressed, in substance, during the Department's extended review of this transaction. Certainly, none of the concerns aired by interested parties can compete with Pan Am's urgent need to realize the benefits of its agreements with United. Each day that passes places greater pressure on the carrier to implement its revised business plan and refocus its efforts. This can only be accomplished with the completion of the instant transaction. Extended delay in obtaining final Department approval would serve no public purpose and would be contrary to the public interest. United and Pan Am urgently request that the Department issue its final order in this matter by January 25, 1991.

Respectfully submitted,

/s/ Joel Stephen Burton
JOEL STEPHEN BURTON
GINSBURG, FELDMAN and BRESS,
CHARTERED
1250 Connecticut Avenue, N.W.
Suite 800
Washington, D.C. 20036
(202) 637-9130

/s/ William T. Coleman, Jr.
WILLIAM T. COLEMAN, JR.
DONALD T. BLISS
O'MELVENY & MYERS
555 13th Street, N.W.
Suite 500 West
Washington, D.C. 20004
(202) 383-5325

CERTIFICATE OF SERVICE

I hereby certify that I have this date served a copy of the foregoing Joint Answer of Pan American World Airways, Inc. and United Air Lines, Inc. to Objections to Order 91-1-11, on all parties named on the Service List by causing a copy to be sent via first-class mail, postage prepaid.

/s/ Kathryn D. North
Kathryn D. North

Dated: January 22, 1991

SERVICE LIST

Carl B. Nelson
American Airlines, Inc.
1101 17th Street, N.W.
Suite 600
Washington, D.C. 20036

Susan B. Jollie
Galland, Kharasch, Morse
& Garfinkle
1054 31st Street, N.W.
Suite 200
Washington, D.C. 20007

Richard B. Jamison
Director of Airport
Detroit Metropolitan Wayne
County Airport
L.C. Smith Terminal
Detroit, MI 48242

John Longstreth
Jonathan Blank
Preston, Gates, Ellis
& Rouevlas Meeds
1735 New York Ave., N.W.
Suite 500
Washington, D.C. 20590

Stephen L. Gelband
Hewes, Morella, Gelband
& Lamberton
1000 Potomac Street, N.W.
Washington, D.C. 20007

Wallace L. Ford, II
City of New York
555 New Jersey Avenue,NW
Suite 700
Washington, D.C. 20001

Charles Angevine
Department of State
Office of Aviation
2201 C Street, N.W.
Washington, D.C. 20590

Robert Cohn
Shaw, Pittman, Potts
& Trowbridge
2300 N Street, N.W.
Washington, D.C. 20037

Bruce Keiner
Crowell & Moring
1001 Pennsylvania Ave., NW
10th Floor
Washington, D.C. 20004

Michael Roberts
Verner, Liipfert, Bernhard,
McPherson & Hand
901 15th Street, N.W.
Suite 700
Washington, D.C. 20005

William Alberger
Stoel Rives Boley Jones
& Grey
1275 K Street, N.W.
Suite 1100
Washington, D.C. 20005

Paul M. Donovan
LaRoe, Winn, Moerman
& Donovan
1120 G Street, N. W.

Washington, D.C. 20005

James Wilding
General Manager
Metropolitan Washington
Airports Authority
National Airport
Washington, D.C. 20001

Jay Franke, Commissioner
Chicago Department of Aviation
20 N. Clark Street
Suite 300
Chicago, IL 60602

Louis A. Turpen
Director - Airports
San Francisco Intl. Airports
P. O. Box 8097
San Francisco, CA 94128

Jerome A. Montgomery
Assistant City Attorney
City Attorney's Office
Department of Airports
1 World Way, Room 104
P. O. Box 92216
Los Angeles, CA 90009-2216

Frederick A. Elder
Peter Reaveley
Dade County Aviation Department
Miami Intl. Airport
P. O. Box 592075 AMF
Miami, FL 33159

Elliott M. Seiden
Vice President Law and
Government Affairs
Northwest Airlines, Inc.
901 15th Street, N.W.
Suite 300
Washington, D.C. 20005

Wesley Kennedy
Cotton, Watt, Jones & King
122 South Michigan Avenue
Suite 2050
Chicago, IL 60603

Michael F. Goldman
Lepon, McCarthy, Jutkowitz
& Holsworth
1146 19th Street, N.W.
3rd Floor
Washington, D.C. 20036

David A. Sorer, Director
Collective Barganing
Ben Elliott
Association of Flight
Attendants
1625 Massachusetts Ave. NW
Washington, D.C. 20036

Frank Cotter
Assistant General Counsel
Legal Department
USAir
Crystal Park Four
235 Crystal Drive, 8th Flr.
Arlington, VA 22227

John E. Gillick
Winthrop, Stimson, Putnam
& Roberts
1133 Connecticut Ave., N.W.
Suite 1200
Washington, D.C. 20036

Joe Sims
Jones Day Reavis & Pogue
1450 G Street, N.W.
Suite 600
Washington, D.C. 20005

Kenneth A. Rowe
Virginia Department of
Aviation
4508 South Laburnum Ave.
Richmond, VA 23231

George N. Kenyon
Associate General Counsel
Trans World Airlines, Inc.
100 South Bedford Road
Mt. Kisco, NY 10549

Stephen B. Moldof
Cohen, Weiss and Simon
330 West 42nd Street
New York, NY 10036

Peter O. Shinevar
Bredhoff & Kaiser
1000 Connecticut Ave. NW
Suite 1300
Washington, D.C. 20036

Patrick J. Riley
International Brotherhood
of Teamsters
25 Louisiana Avenue, N.W.
Washington, D.C. 20001

Arthur M. Luby
O'Donnell, Schwartz
& Anderson
1300 L Street, N.W.
Suite 200
Washington, D.C. 20005

Vincent Tese
Commissioner, Department of
Economic Development
State of New York
1515 Broadway
New York, NY 10036

R. Daniel Devlin
Staff Vice President-
Legislative Affairs
Trans World Airlines, Inc.
808 17th St., NW, Suite 520
Washington, D.C. 20006

Denis F. Gordon
Gordon & Barnett
1133 21st Street, N.W.
Suite 450
Washington, D.C. 20036

R. Russell Bailey
Air Line Pilots Association
International
1625 Massachusetts Ave. N.W.
Washington, D.C. 20036

Charles Kurth
Kurth & Co., Inc.
4400 MacArthur Blvd., N.W.
Suite 303
Washington, D.C. 20007

Claire Shulman
President, Borough of Queens
120-55 Queens Boulevard
Kew Gardens, New York 11424

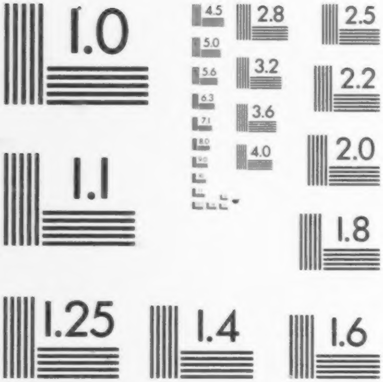
Mark McCall
David Feher
Sullivan & Cromwell
1701 Pennsylvania Ave., N.W.
Washington, D.C. 20006

Marion Kindig
President - R.O.B.
P. O. Box 15503
Washington, D.C. 20003

○

MICROCOPY RESOLUTION TEST CHART

(ANSI and ISO TEST CHART No. 2)


1.0
4.5
2.8
2.5
5.0
3.2
5.6
2.2
6.3
3.6
7.1
8.0
4.0
2.0
9.0
1.1
1.8
1.25
1.4
1.6

PHOTOGRAPHIC SCIENCES CORPORATION
770 BASKET ROAD
P.O. BOX 338
WEBSTER, NEW YORK 14580
(716) 265-1600

20:1

ompilation © 1991 Congressional Information Se